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## **The Development of Cooperatives as Spatially Embedded Entrepreneurial Innovation: The Case of Mondragón**

**Student: Nakou Panagiota**

**Supervisors: Dr. Stamboulis Yeoryios**

**Professor Skayannis Pantoleon**

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## **Abstract**

The continuously changing environment has revealed the emergence of a new business organisation in the capitalist mode of production, the entrepreneurial firm. In this framework, historical, spatial and general conditions appear to be crucial enough to its sustainability. The concept of entrepreneurial firm refers to small, fast growing, and flexible organisations, adaptable in networking. Cooperatives, an alternative organisational model, can be seen in the frame of this theory. Many analysts attribute these organisations' success in terms of efficiency, flexibility and innovation, to their ability to contribute to local prosperity, local/regional development and strengthening. Among other cooperative models, the experiment of Mondragon, a cooperative corporation, appears to be one of the most successful organisational structures. In this dissertation, Mondragon is analysed as an alternative and innovative business organisation in the spatial context of the Basque Country. It aims to highlight those institutional and structural elements underlying this success and the possibility for this model to be diffused or adopted, outside the Basque Country.

**Key words:** cooperativism, entrepreneurship, embeddedness, social capital, clustering

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## 1. Introduction

In the today's socio-economical system, the continuously changing environment, has led to the rise of a new business organisation, which is more flexible and innovative in order to adjust to these changes and also contribute to the development of their local territory. In this scene, the concept of entrepreneurship has arisen, giving new perspective in business organisations. In contrast, since the 18th century, cooperativism, an alternative way of production, was set up as *'a way to protect the interests of the less powerful members of society - workers, consumers, farmers, and producers'* (Rheingold, 2007). Since then, this alternative has spread worldwide, providing equality and democracy in the workplace, and reversing the subordinate relation of labour to capital. Some of them succeeded to remain and become successful in time, while others failed. In this dissertation, one of the most successful cooperative networks, Mondragon, will be analysed as a spatially embedded entrepreneurial innovation.

This dissertation focuses on capturing the elements enhancing Mondragon's success and investigates the possibility of a successful and sustainable transfer.

A brief historical evolution leading to the emergence of a new business organisation is presented in Chapter 2. As mentioned above, the continuously changing environment revealed the need for more innovative and entrepreneurial activity. Literature review of the theory of the entrepreneurial firm will follow, along with concepts, spatial components, promoting these organisations. In the next section, cooperative general values and an innovative theory of cooperatives will be introduced.

Chapter 3 deals with the evolution of Mondragon experiment from its background until today. In this historical review, initiatives, instruments, structural and institutional reforms will be described, in order to reveal the leading elements constructing Mondragon's current function and development. These leading elements will be analyzed in Chapter 4, in order to reveal some of the main factors contributing to Mondragon's success and to investigate the possibility of a sustainable transfer outside Basque territory. Chapter 5, summarizes the conclusions of this project.

As it concerns methodology, research was based on secondary sources consisting of books, papers, scientific journals and internet sources.

## **2. Literature review of the concept of entrepreneurship and cooperatives**

This chapter focuses on the concept of entrepreneurship, as a part of the innovative transformation of the new business process that takes place in the last decades. In this field the rising of an alternative way of production – cooperativism – has emerged. In this Chapter I present the theoretical context of this dissertation.

### **2.1. Business Organisation**

#### ***2.1.1. Capitalist Evolution***

The nineteenth century - when the First Industrial Revolution took place - was characterized according to many analysts as *Proprietary Capitalism* (Lazonick, 1991). Later, during the first decades of the twentieth century, proprietary capitalism gave way to managerial capitalism (Second Industrial Revolution), as the first proved inadequate to deal with the technological complexities and the attendant high fixed costs of the new industrial era (Lazonick, 1991: 27). However, the last two decades, another transition in capitalist production has appeared defined as Collective Capitalism (Lazonick, 1991). In this *Third Industrial Revolution*, new perspectives on business organisation appear. These are summarized in: *'the organisational integration of a number of distinct firms in pursuit of a common investment strategy, the long-term integration into the enterprise of personnel below the managerial level, and the cooperation of the state in shaping the social environment to reduce the uncertainty facing private-sector investments'* (Lazonick, 1991: 24).

#### ***2.1.2. The Principal Agent Problem***

Since *managerial capitalism*, the principal agent problem has appeared. In general terms, *'the agency problem arises whenever one or more individuals, called principals, hire one or more other individuals, called agents, to perform some service and then delegate decision-making authority to the agents'* (Kleiman, 2011). The principal agent problem lies in any contract or relation that is characterized by asymmetric information, risk and uncertainty (Fazzari et al., 1988). Lazonick (1991) claims that the agent principal problem seems to decrease with planned coordination of the activities of groups of individuals who participate in hierarchical and functional divisions of labor is



one of its defining characteristics. The success is attributed to individuals' personal involvement in the performance of work that furthers the organisational goal (Lazonick, 1991: 79). This could be successfully achieved by motivating employees to be interested in organization's goals, offering them relevant rewards for the work they perform (Lazonick, 1991: 79). So, more potent benefits are being offered to employees not simply by high wages and salaries, but also by long-term job security and social mobility within the organisation (Lazonick, 1991: 182).

Another aspect examines the relation between agency problem and innovative strategies. In this aspect investment in training and R&D appear crucial. Organisations choosing innovative strategies combine human and physical resources according to well-known technical specifications in order to produce a saleable product at a competitive cost (Lazonick, 1991: 270).

Investment in innovation creates both an economic problem and an economic possibility for the enterprise. The economic problem is that, given the high fixed costs incurred, the innovating enterprise will be at a competitive disadvantage relative to its less venturesome competitors if it does not succeed in capturing a large market share. But the economic possibility is that success in developing superior processes and products will provide it with a basis for increasing its extent of the market in ways that its competitors cannot.

Lazonick, 1991: 133

However, in order to be successful an innovative strategy has to be combined with planned coordination (Lazonick, 1991).

The training system within the organization must be planned, because the nature of product and process innovation being attempted determines the nature of the specialized division of labor the organization must have at its disposal. The development of human resources must become an integral element in the long-term planning process required to generate and implement all innovations. If the organization is successful in this planned coordination of a specialized division of labor, it in effect not only broadens the "bounds" of individual rationality but also transforms the array of individual rationalities embodied in the specialized division of labor into a collective rationality.

Lazonick, 1991: 299

So, the principal-agent problem, although seems to be rooted in capitalist business organization, in terms of game theory involves changing the rules of the game so that individuals' rationalities coincide with the organisation's collective rationality (Lazonick, 1991, Kleiman, 2011).

### 2.1.3. *Entrepreneurship*

As it was mentioned before, collective capitalism requires cooperation of the state in shaping the social environment to reduce the uncertainty facing private-sector investments (Lazonick, 1991: 24). In this scene, from the early 1970s, closer links between the public and private sectors appeared, promoting local areas to attract new business (Harvey, 1989). The spatially grounded set of social processes that Harvey calls urbanisation had to be much more innovative and entrepreneurial, willing to explore all kinds of avenues through which to alleviate their distressed condition and thereby secure a better future for their populations (Harvey, 1989). There was a shift from "managerialism" to "entrepreneurialism" (Harvey, 1989). So, in this part the concepts of entrepreneurship and entrepreneur must be clarified.

Most definitions used in literature for entrepreneurship and entrepreneur are a mix of the above three. Some examples:

*'Entrepreneurship is a way of thinking, reasoning, and acting that is opportunity obsessed, holistic in approach, and leadership balanced'*

Timmons, 1999: 27.

Entrepreneurship is the process whereby an individual or a group of individuals use organized efforts and means to pursue opportunities to create value and grow by fulfilling wants and needs through innovation and uniqueness, no matter what resources are currently controlled.

Coulter, 2001: 6

An entrepreneur is one who creates a new business in the face of risk and uncertainty for the purpose of achieving profit and growth by identifying opportunities and assembling the necessary resources to capitalize on them. Although many people come up with great business ideas, most of them never act on their ideas. Entrepreneurs do.

Zimmerer and Scarborough, 2002: 4

Entrepreneurship is a dynamic process of vision, change, and creation. It requires an application of energy and passion towards the creation and implementation of new ideas and creative solutions. Essential ingredients include the willingness to take calculated risks- in terms of time, equity, or career; the ability to formulate an effective venture team; the creative skill to marshal needed resources; the fundamental skills of building a solid business plan; and, finally, the vision to recognize opportunity where others see chaos, contradiction, and confusion.

Kuratko and Hodgetts, 2004: 30

A more appropriate definition is given by Bjerke (2007) claiming that: *'Entrepreneurship means to create new user value and to come up with new applications which others can use (as well) to fill a need and/or satisfy some demand, existing or created'*. Furthermore, Bjerke (2007) upholds that *'the research field of entrepreneurship (from an explaining point of view) can be defined as covering the process of development of new business ventures, including the ways in which chances and opportunities for such ventures arise and how they are manifested in new organizations'* (Bjerke, 2007: 75).

As it concerns the concept of *entrepreneur* in literature, entrepreneur is the one *'who sees an opportunity, figures out a way to acquire the needed resources, and acts to turn the opportunity into a reward'* (Cox, 2002). His primary purpose is to choose among various combinations of inputs, suitable for producing particular goods (and to decide whether these goods should be produced at all), based on current prices for factors and expected future prices of final goods (Knight, 1921, cited in Foss and Klein, 2004).

Other authors estimate that entrepreneurship can also help individuals, families, organisations, and communities to turn opportunities into actions to maintain or increase well-being (Cox, 2002). *'If capital is a single "good", with one price, then entrepreneurship is reduced to choose between capital-intensive and labor-intensive production methods, or among types of labor'* (Foss and Klein, 2004). The wealth that comes from increased well-being can be cultural, social, environmental, or even financial. *'Entrepreneurship is not a single all-or-nothing trait'* (Cox, 2002).

Foss and Klein (2004) come up with a different aspect on the term called "productive entrepreneurship", which is the creation or discovery of new attributes leading to an increase in joint surplus (Foss and Klein, 2004). So, "productive entrepreneurship" (Foss and Klein, 2004), or entrepreneurship at its best (Bjerke, 2007) creates new ideas, new products, more jobs, increase in joint surplus and is vital for the economic development of a country, a region or a local area. *'This analysis indicates that changes in the economic structure and market processes within a country leading to economic growth may occur more quickly when an active entrepreneurial sector is available to implement such changes'* (GEM, 2002: 22).

Another interesting approach on the concept lies in the work of Skurnik (2002), who claims that there is no simple theory or practice that determines what forms of company

should exist, their characteristics or the details of their regulation. '*The entrepreneur-owner can usually avoid costly negotiation with those who are affected his creation or discovery. This keeps the dissipation of value at bay.*' (Foss and Klein, 2004) In this concept, entrepreneurship cannot occur if the group is not committed to an idea using it to produce well-being in future (Cox, 2002). Further, education and training play major role, as they can encourage entrepreneurship (Cox, 2002). Moreover, Kuratko (2007) claims that the true value that entrepreneurship gives lies in the extent to which it helps organizations create sustainable competitive advantage. According to McGrath and MacMillan (2000), there are certain ongoing responsibilities that managers in entrepreneurships should assume.

The first responsibility involves "framing the challenge", which means that there needs to be a clear definition of the specified challenges that everyone involved with innovative projects should accomplish. The second is to "absorb the uncertainty" that is perceived by team members. It suggests the creation of self-confidence that lets others act on opportunities without seeking managerial permission. A third responsibility is to "define gravity" — that is, what must be accepted and what cannot be accepted.

Kuratko, 2007

Finally, another perspective is given by Harvey (1989), proposing that "entrepreneurialism" focuses much more closely on the political economy of place rather than of territory, meaning the kind of economic projects (housing, education, etc.) that are designed primarily to improve conditions of living or working within a particular jurisdiction.

Given the right circumstances, urban entrepreneurialism and even inter-urban competition may open the way to a non zero-sum pattern of development. This kind of activity has certainly played a key role in capitalist development

Harvey, 1989

Entrepreneurship, whether individual or collective, is not enough to generate economic development. According to Lazonick, innovative entrepreneurial strategies are the key issue and they should be followed by the building of organizational structures in order to plan and coordinate innovation and throughput (Lazonick, 1991: 183).

The success of organizational capability in generating economies of scale and scope depends on the development and utilization not only of physical resources but, even more fundamentally, of human resources. The individual efforts of those involved in the enterprise's specialized division of labor must be planned and

coordinated - in effect, collectivized - to create a powerful productive organization.

Lazonick, 1991

However, the places characterized by "entrepreneurialism" can be viewed as a means to procure benefits for populations within a particular jurisdiction, which is a primary claim made in the public discourse developed to support them (Harvey, 1989).

But for the most part, their form is such as to make all benefits indirect and potentially either wider or smaller in scope than the jurisdiction within which they lie. Placespecific projects of this sort also have the habit of becoming such a focus of public and political attention that they divert concern and even resources from the broader problems that may beset the region or territory as a whole.

Harvey, 1989

#### ***2.1.4. Participative management***

As response to the agency problem alternatives in management also appeared, enhancing organisations' function, representing democratisation and participation. In literature has been variously identified as cooperative, participative, alternative, self-management etc.

*'A basic principle of management is to identify potential customers, learn their needs, then make products and provide services that they want at a price they can afford and that will make a profit for the company'* (Witzel, 2004) Participative management may vary from the *classical* term ,but, the basic principle remains the same. So, differences lie mainly in the role management has inside the enterprise and how is applied.

According to Delacroix (2010) participative management means:

- to foster free circulation of information within the company
- to establish, support and reward behaviors based on trust and mutual help
- to make sure that the company's best interest is also the best interest of its employees in order to induce them into participating
- To mobilize human skills, processes, as well as financial and technological resources so that the company's goals can be reached

Delacroix, 2010

According to Walton, (1991), in participative management a commitment strategy is needed to provide *stretch objectives*, emphasise continuous improvement, and reflect the requirements of the market place (Walton, 1991).

In another aspect, the importance of developing a corporate sense, communication in all levels of an organisation and specified roles and responsibilities in management, are highlighted (Bartlett and Ghoshal, 1991). Through participative management, all these combine a vision, which should be crafted and articulated with clarity, continuity, and consistency (Bartlett and Ghoshal, 1991).

Clarity includes three keys: simplicity, relevance, and reinforcement. Simplicity so as the vision would summarize the strategic and organizational imperatives of the cooperative, relevance means linking broad objectives to concrete agendas and reinforcement is needed in order to keep the core vision from becoming obsolete or abstract (Bartlett and Ghoshal, 1991). By continuity they mean that companies must remain committed to the same core set of strategic objectives and organisational values and finally consistency is to ensure that everyone in the company shares the same vision, so as chaos and confusion will be successfully avoided (Bartlett and Ghoshal, 1991).

In literature multiple organisational types of participative management can be found, like the transformation of the organisational pyramid to a circled one (Semler, 1991). In other words, "distance" between the top and the bottom is reduced, making corporate management more effective. In most cases there is a management council interacting with a general assembly and other councils, individuals or groups of workers.

A standard meeting may include information and decision-taking about: technical problems related to the production line, investments in new machines or maintenance, market perspectives, relationships with clients, income distribution, the development of new products, legal matters, the recruitment of new workers, extension of the working day and holidays, participation in demonstrations and solidarity events, and so forth.

Atzeni and Ghigliani, 2007

Another type deals with parallel organization led, by a steering committee, which gives *'the link between the formal, hierarchical organization that carries out routine, ongoing operations and the flatter, more flexible parallel organization that seeks employee participation'* (Boyle, 1991). The steering committee composed of senior managers, sets limits, objectives, and accountability for the teams, requires the teams to make formal plans and schedules and recognizes and rewards the teams when their work is finished (Boyle, 1991).

Finally, the contribution of Walton's work (1991) is important, as he emphasized the importance of giving employees voice and access on process and issues as production methods, problems and solving. *'In unionized settings, the additional tasks include making relations less adversarial, broadening the agenda for joint problem solving and planning, facilitating employee consultation'* (Walton, 1991).

To sum up, participative management appears enhancing business organisation and entrepreneurial activity providing further motivation through the access in decision making, voice on organisational challenges and a share vision. Furthermore, it promotes cooperation among employees and gives organisation the opportunity to confront better upcoming challenges.

## **2.2. Spatial Components**

As presented in the previous section entrepreneurial firms seem to be a successful business organisation, which with the right conditions, can provide economical business growth or even local development. These conditions can be enhanced by some special conditions, such as participative management, clustering, social networks and the embeddedness in space. These spatial components are described below.

### ***2.2.1. Social Capital***

Another *special component* of the theory of the entrepreneurial firm lies in the concept of social capital. Social Capital is *'the seemingly non-economic variables, which capture various aspects of the social structure in a society'* (Torsvik, 2000). Therefore, it is *'an investment, in friendships and in community, familial, church or school activities which are later appropriated. And it is inherent in relationships and the social structure that arises from them'* (Koput, 2010).

According to Koput (2010), Social Capital is a productive resource that can be used to create value; an investment, with an element of risk; inherent in relationships, not actors requiring a social structure and joint participation; and appropriable (Koput, 2010). There are three forms, or substances, of social capital: Obligations, Information Channels and Norms (see Koput, 2010). *'It also has to be distinguished from standard economic measures of physical and human capital'* (Putnam, 1993).

Furthermore, social capital appears as the *missing link* in theories of economic development and plays vital role in our understanding of economic development

(Putnam, 1993). *'It has to do with the social structures these other types of capital are embedded in'* (Torsvik, 2000). Fine (1999, cited in Lin et al., 2001), refers to social capital as *'something over and above other types of capital but, as such, it seems to be able to be anything ranging over public goods, networks, culture, etc'*. Lin et al. (2001) claims that *'is rooted in social networks and social relations, and can be defined as resources embedded in a social structure which are accessed and/or mobilized in purposive actions'*. Its notion contains three ingredients: resources embedded in a social structure, accessibility to such social resources by individuals and use or mobilization of such social resources by individuals in purposive actions (Lin et al., 2001).

The concept has also proposed to explain why societies may be more productive than it can be explained by evaluating their material resources (Krishna and Uphoff, 2002). Coleman (1988), sees social capital as a variety of different entities, with two things in common: (1) consisting of some aspects of the social structure, and (2) facilitating certain actions of actors within the structure. *'This broader concept of social capital includes vertical as well as horizontal associations among members in a community. In vertical associations it is important to assess the patterns of hierarchical relations and the power distribution among citizens.'* (Torsvik, 2000) Narayan and Prichett (1999) measure social capital as the *'quantity and quality of associational life'*, supporting it creates trust and cooperation among citizens living in a community. *'Communities with a high density of tight and inclusive networks of individual contact will experience an atmosphere of mutual trust, and trust enables individuals to cooperate and work more efficiently together'* (Torsvik, 2000).

In addition, social capital is inherent to development. *'Social capital represents cognitive and structural assets that create propensities and capacities for mutually beneficial collective action'* (Krishna and Uphoff, 2002). These assets come from roles, networks, and other social relationships that facilitate cooperative behavior and from norms, values and other cognitive commitments that predispose people to work together for mutual benefit (Krishna and Uphoff, 2002). However all these can operate efficiently only if sets of individuals agree on them. It is a product of collective thinking and the activities it represents are more than the sum of individual actions and cognition (Krishna and Uphoff, 2002). *'Collective action becomes more likely and successful when individuals in a community abide by rules that have been constructed through joint consultation rather than by force or outside coercion'* (Ostrom, 1990).



Finally, as Krishna and Uphoff (2002) support, how local organizations are structured and the relationships that their leadership and membership roles establish affect how people learn and think about their social responsibilities and social activity. So, Social Capital appears to be an important factor empowering "entrepreneurialism" as it affects business organisation on the one hand, while in the other business organisation reshapes social capital.

### 2.2.2. Clustering

Another element promoting organisations is the cluster phenomenon. Many firms, sharing common interests cooperate, in order to achieve development and utilization of their productive resources (Lazonick, 1991: 8). In many cases this cooperation takes spatial dimension resulting the creation of clusters. The concept took its origin from the success of Silicon Valley. Saxenian (1994, 1998, cited in Ganne and Lecler, 2009) has characterised it as a '*decentralised regional network based on industrial system*'.

Clusters can be defined as groups of companies and institutions collocated in a specific geographic region and linked by interdependencies in providing a related group of products and/or services (Porter, 1998). They have two defining characteristics, geographical concentration and industrial specialization (Wang, 2009). Krugman (1991) emphasizes the important impact of the geographical factor on economic activities, while others focus on industrial specialization because of the importance in measurement of development types from an evolutionary perspective (Brusco, 1990).

Many authors find connection between the level of division of labor and the extent of inter-firm interaction in a cluster. So, the lower the level of division of labor is, the less firms interact with the others (McDonald and Vertova, 2002). In contrast, the more inter-firm specialization develops, the more a firm trades, cooperates and interacts with the others (McDonald and Vertova, 2002). Industrial clusters are the most common type, consisting of industries with close economic links (Yingming, 2010).

It provides a favorable development environment for a regional self-support growth process. Regional economic activities can attract the inflow of production factors from outside regions so that new productive activities can be introduced, production chains can be extended, and multiplier effects of regional productive activities can be remarkably heightened. With further development of regional industrial clusters, multiplier effects become quite strong, and rapid economic growth process accompanies the change in economic structures.

Yingming, 2010: 12

The opportunities arising through industrial clusters are twofold. On the one hand, industries belonging in clusters have lower transaction costs and they also maximize market benefits (Yingming, 2010). On the other hand *'industrial sectors of different sizes and types incur, are formed, and develop economic links among industrial sectors and form a relatively integrated industrial "aggregation" together'* (Yingming, 2010).

As Porter (1998) argued, clustering and specialization in a region are regarded as the key elements of growth and competitiveness, due to the reduction in transaction costs, agglomeration economies, and technological and skill advantages. However, *geographic proximity only creates a potential for interaction, without necessarily leading to dense local interaction. The richness of cluster effects depends on the behavior of cluster participants* (Wang, 2009: 329).

In literature two main factors characterise clusters: a comparative perspective and a dynamic process (Nelson and Winter, 1982, Wang, 2009). The first one comes from their positive externality (Marshall, 1920, cited in Wang, 2009), externality-based knowledge spillover (Lundvall and Johnson, 1994), flexible specialization (Piore and Sabel, 1984, cited in Wang, 2009), saving transportation costs for the increasing returns to scale in the spatial clustering process (Krugman, 1991), cooperation-based collective efficiency (Humphrey and Schmitz, 1996), reducing transaction costs based on the embedded social relation and the trust with each other within clusters (Granovetter, 1985; Pitelis, 1998), and diminishing the learning costs for adaptation to increasing internal and external changes (Lundvall and Johnson, 1994).

In a dynamic process different results may come up, as not all clusters can sustain their earlier growth performance (Amin, 1999, Lyons, 2000). There may be different reasons for downturn, ranging from local dynamics to external conditions (Kautonen, 1996). *'If a cluster cannot make its institutions, the competitive environment will become rigid and lose responsiveness, and a regional force will evolve'* (Wang, 2009). However, adjustment is not easy as paths are often historically dependent (Antonelli, 1997). The evolution of clusters may take many years, often decades. *'Although the emergence of a cluster could be triggered by chance events, a cluster tends to have a life of its own'* (Wang, 2009). The inherent economics of proximity have been enough to attract increasing numbers of firms and other institutions in consequence, leading to a self-reinforcing cycle (Porter, 1990, cited in Wang, 2009). *'This is often referred to as the*

*lock-in effect. Consequently, competitive advantages may also turn into disadvantage'* (Wang, 2009). This can happen if a deep structural adaptation does not rapidly take place in response to major internal and external changes (Guerrieri and Pietrobelli, 2004). So, in order to avoid being locked-in, continuous innovation is deemed necessary (Wang, 2009).

Clusters are often used as a policy tool to *'promote competitiveness by innovation, clusters and poles of competitiveness, even if they develop on the basis of pre existing spontaneous industrial districts, appear as politico-economical constructs at the interface between sciences and technology on the one hand and production on the other hand'* (Ganne and Lecler, 2009). This is because clustering is directly linked with interaction, research and development, learning and innovation (Wang, 2009). However, *it does not confirm that a cluster will necessarily become a dynamic centre for innovation'* (Wang, 2009). What makes clusters a hotspot of innovation is the existence of leader firms, in order to reinforce a linkage between interaction and innovation, as they have more access to finance, control over technology and organizational capabilities, can combine their linkages with external universities and research organisations which enable them to generate and transfer knowledge, they are connected with the spin-off firms that have grown under their umbrella and can play a dominant role in constructing a product production network based on a value chain through outsourcing and sub-contracting within clusters (Wang, 2009). *'Particularly, large firms might integrate local productive resource into global networks'* (Wang, 2009).

Another perspective argues that *knowledge spillovers* are a key factor in *innovative clusters* (Breschi and Malerba, 2001). *'This argument is based on the properties of the knowledge base used in innovative activities and the associated means of knowledge transmission and communication'* (Breschi and Malerba, 2001). Proximity lowers knowledge transmission costs and knowledge can be only effectively transmitted through interpersonal contacts and inter-firm mobility of workers, both of which are eased by close geographical and cultural proximity (Breschi and Malerba, 2001).

So, to sum up, organisations deciding to form clusters maximize their economic benefits promote regional, national or local development and create possibilities to further R&D and innovation favouring both organisations and their local community.

### 2.2.3. *Social Networks*

An inherent concept to the previous two, that deals with the concept of social networks.

Researchers use social networks to understand and change human behaviors. Social networks are measured and defined as connections among people, organizations, political entities (states or nations), and/or other units. Social network analysis is a theoretical perspective and a set of techniques used to understand these relationships and how they affect behaviors.

Valente, 2010

Social network analysis is used to provide an in-depth understanding of how behaviors are distributed in a network and the factors associated with behavior change (Valente, 2010). *'Relationships are the very life blood of successful social entities and the cycles of innovation within them. They are also fundamental as we develop and maintain our individual and group identities. To access this powerful resource, we need to reach beyond transactions and conversations within and beyond our organizations.'* (Ethin, 2009)

So, the social network analysis is crucial enough for an organization to achieve close ties with its social environment, to cooperate with other firms and to provide flow of information, knowledge or even innovation (Buller et al., 1999).

Granovetter (1985) emphasized the role of informal social networks in labour markets. He found that over 50% of jobs were found through personal contacts. Other analyses on the concept indicate that positions in social networks play a predominant role for economic outcomes (Buechel, 2009). This means that *'companies which occupy a very "central" position are considered to better acquire and exploit knowledge that finally promotes their performance'* (Buechel, 2009: 96).

In conclusion the concept of social networks includes the ties an organization and (autonomously) its members can create within its social environment. Social networks can provide knowledge, information, human capital, data etc., which, used appropriate, may contribute to its development.

### 2.2.4. *The role of Embeddedness*

The previous components, are further empowered through the concept of embeddedness, as they reflect an organisation's relation with its environment (community or cluster). So, it is important to define the concept.

*'The term of embeddedness was introduced by Polanyi (1944) but has come into increasingly popular use in the social sciences since the publication of Granovetter's (1985) classic article, linking economic activity with the structure of social relations'* (Boons and Howard-Grenville, 2009). Embeddedness is multi-level. (Dacin et al. 1999, Hagedoorn 2006). In literature there are many different dimensions of embeddedness to account for the contextualization of organizational activity more broadly and to draw attention to how social structures and processes enable particular activities (Powell et al. 1996, Dacin et al. 1999). It is also used to analyse the creation of networks. As Powell et al. (1996) supports, when firms keep arm's-length ties with one another, the pattern of exchanges produces a market-like structure; when they maintain embedded ties, the pattern of exchange produces a network. Some of its dimensions are the following:

- i. Cognitive embeddedness
- ii. Cultural embeddedness
- iii. Structural embeddedness
- iv. Political embeddedness
- v. Spatial and temporal embeddedness
- vi. Social Embeddedness

i) Cognitive embeddedness refers to the limits on individuals' mental processes that arise from decision making under conditions of uncertainty, complexity and limited information (Zukin and DiMaggio 1990). *'It resembles the concept of "bounded rationality" which has been used to explain limits to rational action within organizations'* (Boons and Howard-Grenville, 2009).

ii) Cultural embeddedness captures the influence of collective understandings and shared norms on economic and organisational behavior (Zukin and DiMaggio 1990). It operates at a collective level and helps in understanding the cultural norms in a territory, so as to define what is legitimate and valued within a certain sector of economic, organizational and social activity (Boons and Howard-Grenville, 2009: 15).

iii) Structural embeddedness refers to 'the contextualization of economic exchange in patterns of ongoing interpersonal relations' (Zukin and DiMaggio 1990: 18). *'Here the structure of social interactions between actors shapes whether and how information and*

*influence flow, and ultimately shapes economic and other forms of exchange'* (Boons and Howard-Grenville, 2009).

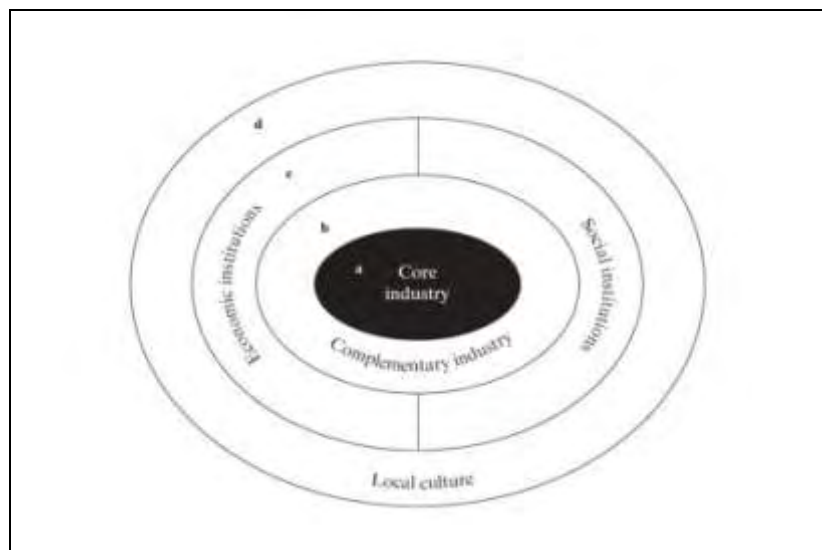
iv) Political embeddedness is *'the manner in which economic institutions and decisions are shaped by a struggle for power that involves economic actors and nonmarket institutions, particularly the state and social classes'* (Zukin and DiMaggio, 1990: 20). In literature the term of political embeddedness is usually used to explore how a particular policy shapes organizational action, to suggest policies developed or implemented at a territorial level in order to influence corporate environmental activities, or to reveal how nongovernmental organizations have influenced companies' actions (Boons and Howard-Grenville, 2009).

v) Spatial and temporal embeddedness is used to analyze the ways in which geographical proximity and time influence interact (Boons and Howard-Grenville, 2009).

Physical proximity has been identified as a crucial catalyzing factor in, for instance, the occurrence of complex forms of learning and the building of trust. Time is important as the evolution of industrial systems typically involves long time periods. Furthermore, time also matters because it is the "measure" by which we see accumulations in other dimensions of embeddedness. For example, repeated interactions over time can be associated with growing trust and learning.

Boons and Howard-Grenville, 2009: 18

vi) Social embeddedness is specially used to understand the inter-firm relationships embedded in social relations which are key enablers of ongoing industrial symbiosis (Jacobsen and Anderberg, 2005). Figure 2.1 shows the different layers of social embeddedness among firms in a given business network (Boons and Howard-Grenville, 2009).

Figure 2.1: *Layers of embeddedness surrounding inter-firm relations*

Source: Johannisson et al., 2002

In the figure letters represent the following:

- a- one-to-one relations between firms in the same core industry
- b- relations between firms in a core industry with those in complementary industries
- c- direct or indirect relations through shared membership in local economic or social institutions
- d- shared norms through the overarching culture governing institutional and business relations

Johannisson et al., 2002

*'Firm relations can be embedded at each of these levels, from very simple dyadic relations between a pair of firms, to complex ones that occur on multiple layers. Firms with more complex relations are expected to be more embedded within the system than those with only simple ones'*. (Boons and Howard-Grenville, 2009) Uzzi (1996) supports that structure and quality of social ties among firms shape economic action by creating unique opportunities and access to those opportunities. As he adds, *'the type of network in which an organization is embedded defines the opportunities potentially available; its position in that structure and the types of interfirm ties it maintains define its access to those opportunities'* (Uzzi, 1996).

An interesting view on the concept lies in its relation with entrepreneurship. *'Social embeddedness is relevant to entrepreneurship because it helps the entrepreneur identify social resources, an essential step to founding organizations'* (Naoki, 2004, cited in

Boons and Howard-Grenville, 2009). Furthermore, being embedded within the social context means access to more support during the entrepreneurial process but also a likelihood of increased entrepreneurial activity (Jack and Anderson, 2000). However, embeddedness can also act as a constraint (Jack and Anderson, 2000). Uzzi (1996) identified conditions when embeddedness can be turned into a liability, for example: the unforeseeable exit of a core network player; institutional forces rationalizing markets; even over-embeddedness stifling economic action when social aspects of exchange supersede economic imperatives.

Being embedded in the social structure creates opportunity, improves performance and enables entrepreneurs to use specifics of their environment. Thus *'both recognition and realization of opportunity are conditioned by the entrepreneurs' role in the social structure'* (Jack and Anderson, 2000).

In addition, embeddedness helps in the creation of mutual trust between community and local society, which is particularly important for organisations' viability. The created opportunities that exist within the local structure can only become manifest by the action of embedded entrepreneurial agency (Jack and Anderson, 2000). This is crucial enough, as these opportunities are not available to others who are not embedded. *'Entrepreneurial embedding therefore creates a link between the economic and the social spheres. This social bond enables entrepreneurs to more effectively exploit economic opportunity'* (Jack and Anderson, 2000). The extent to which the entrepreneur is socially embedded and how it is embedded will affect its ability to draw on social and economic resources (Jack and Anderson, 2000).

Some authors support that networks *'are already embedded in their broader "network" of economic and social relations'* (Provan et al. 2007: 481). Uzzi (1996) argues that embedded business networks are expected to have high levels of social capital, meaning that they avail resources and opportunities to member firms and that the interactions of members are motivated not only by immediate economic returns but also by their relationships with others (Uzzi 1996). Boons and Howard-Grenville, (2009) also prop that *'high levels of cooperation, resource sharing and adaptive learning are also more commonplace in embedded networks, which provides benefits that arms-length market transactions do not'*.



In conclusion, embeddedness is a concept which includes many parameters and is especially useful for the understanding of organizational and economic development. An embedded organisation has more opportunities than others who are not embedded. Different dimensions described above, must be considered as *'operating simultaneously, though not with equal strength and salience in all cases'* (Boons and Howard-Grenville, 2009). The intensity of embeddedness can differ between actors and situations, and the interaction across the levels of embeddedness take on different forms (Dacin et al., 1999). Ultimately, influence of the embeddedness of particular organizations in particular contexts must be explored with attention to a particular outcome of interest (Boons and Howard-Grenville, 2009).

### **2.3. Cooperatives – general principles and types**

As it was described above capitalist way of production has evolved through time. However, an alternative – non capitalist - way of production, "cooperativism", has appeared since the late 18th and 19th centuries (Rheingold, 2007). *'Early co-ops were set up as a way to protect the interests of the less powerful members of society - workers, consumers, farmers, and producers'* (Rheingold, 2007). Since then, cooperatives have spread all over the world, being in some cases the local way of production. So, in this subchapter, cooperative ownership and co-ops as a model will be described.

#### ***2.3.1. Cooperative principles and values***

The cooperative model differs from other types and models of organisations due to its collective ownership model, its structure and its basic aims (Skurnik, 2002).

A definition given by the International Co-operative Alliance (ICA), in 1995, describes cooperatives as *'an autonomous association of persons united voluntarily to meet their common economic, social, and cultural needs and aspirations through a jointly-owned and democratically-controlled enterprise'*.

*'As the Industrial Revolution expanded in the nineteenth century, controversy and agitation over ownership and related issues became increasingly widespread and militant'* (Freundlich, 2009). Through time, debates in political philosophy and political economy have resulted in many different aspects on cooperative ownership. However, an attempt to conceptualize some general principles developed in cooperative

movements will follow. As it was mentioned above, in capitalist organisations, ultimate control is in principals' (or shareholders) heads, capital is primary and labor is a tool (Freundlich, 2009). In co-ops these roles are reversed, with labor being primary – control on worker-members – and capital being an instrument (Freundlich, 2009). *'This role reversal has at least two crucially important implications'* (Freundlich, 2009: 9). The first one lies in the democratic member control, where primary cooperatives members have equal voting rights (one member, one vote) and cooperatives at other levels are also organized in a democratic manner (ICA, 1995, Freundlich, 2009). The second lies in economic participation, where capital is usually the common property of the cooperative (ICA, 1995, Freundlich, 2009).

In almost all cases, worker-members do make an initial capital investment, and their capital holdings can vary over time if new investments are required, if the firm loses money or if it makes money and distributes earnings internally, to the workers' "internal accounts", and not in cash.

Freundlich, 2009: 10

So, the critical distinction between cooperative and conventional firms is the legal-philosophical source of rights in the firm, deriving from one's contribution of labor to the organization in the first and not from one's contribution of capital as concerns the second (Freundlich, 2009). Some other general principles lie in voluntary and open membership without racist discriminations, cooperation among cooperatives and concern for the sustainable development of their communities (ICA, 1995). Furthermore, they *'provide education and training for their members, elected representatives, managers, and employees so they can contribute effectively to the development of their cooperatives'* (ICA, 1995).

### **2.3.2. Knowop or Knowco-op**

An alternative perspective on the concept of cooperatives can be found in Hodgson's (2001) book *'Economics and Utopia: Why the Learning Economy Is Not the End of History'*. In his book Hodgson describes a different cooperative called knowop or knowco-op.

In his analysis Hodgson claims that *'economy becomes relatively less machine-intensive and more and more knowledge-intensive'* (Hodgson, 2001: 184). Furthermore, he supports that *'common ownership could develop alongside private ownership'*

(Hodgson, 2001: 216), and that *'the extension and interlocking of ownership rights in the firm, involving the workers themselves to substantial degree, create incentives for longer- term employment'* (Hodgson, 2001: 216).

So, in his scenario, goods or services produced are owned by the corporation, instead of the workers. *'However, the workers possess significant immaterial and knowledge-based assets. There is not necessarily common, complete and exclusive ownership of the corporation by the workforce.'* (Hodgson, 2001: 212) He claims that the actual ownership of the physical means of production in such a knowledge-intensive system is relatively less important (Hodgson, 2001: 217). However, *'the balance of ownership shifts crucially from the shareholders to the workers'* (Hodgson, 2001: 217). Furthermore, *'knowledge is more sophisticated and has an enhanced role'* (Hodgson, 2001: 217). It also requires a high social valuation of trust-based and extra-contractual relationships, a strong co-operative and trust-intensive culture, long-standing relationships, the building up of common norms of evaluation, shared values and objectives, and matching cognitive frameworks. (Hodgson, 2001: 213-218). Finally, there is high strategic significance of brand labels and control of knowledge accreditation (Hodgson, 2001: 214).

Some advantages favouring knowco-ops compared to other cooperatives are the following: The bureaucratic costs may not increase at the same rate as the firm itself and may be swamped by the positive benefits of scale in the knowledge-intensive firm, as greater worker participation in management, flatters management hierarchies (Hodgson, 2001: 225). *'Further, with knowledge-intensive work, there are not decreasing returns, with respect to the labour input'* (Hodgson, 2001: 225). The cost of required physical capital equipment in a knowledge-intensive system is relatively cheap, and their effects on unit costs are likely to be swamped by other factors (Hodgson, 2001: 225). *'The collective and interactive nature of much knowledge also may mean that increasing rather than decreasing returns dominate'* (Hodgson, 2001: 225). Finally, *'learning in knowco-ops leads to "endogenous growth": that is, growth even without an increase in factor inputs, such as the number of employees or in capital investment'* (Hodgson, 2001: 225).

Between a knowledge-intensive capitalist firm and a knowledge-intensive worker knowco-op there are two advantages favouring knowco-ops. *'Empirical evidence, from the West to the East indicate that the more participatory knowledge-intensive firms within capitalism are often more productive and bring higher rates of growth'* (Hodgson, 2001: 226). So, given the assumption that production is a social process, and technology is itself conditioned by its cultural and institutional integument, knowco-ops seem to outperform their capitalist rivals, assuming that the underlying technology does not change (Hodgson, 2001: 226). The second advantage lies in the objectives of firms (Hodgson, 2001: 226). Given the assumption that firms have to devote themselves to the unquantifiable enhancement of future knowledge as much as to profit, their objectives become multiple and diffuse, qualitative as well as quantitative (Hodgson, 2001: 227). So, if capitalist firms focus solely on their pecuniary "bottom line" then they would lose out to their innovating and dynamic rivals, something that does not happen to knowco-ops (Hodgson, 2001: 227).

In this chapter the evolution of capitalist mode of production was summarized, revealing the need for a new business organisation and in this framework, the emergence of entrepreneurial firms. Some spatial components contributing in business organisation followed, so as to reveal the conditions enhancing entrepreneurship. Finally, cooperative production, was presented, revealed through its main principles and values found in literature. In the next chapter, the evolution of one of the most successful cooperatives, Mondragon, will be presented.

### **3. The case study of Mondragon Corporation**

In the previous chapter, theory of the entrepreneurial firm and the concept of cooperatives were introduced. This chapter focuses on the development of one of the most successful cooperative corporations, Mondragon.

Mondragón Corporation is a network of industrial, agricultural, and retail firms that produces a range of goods from bicycles and copper tubing to computerised machine tools and industrial robots (Mondragon, 2010). It is located mainly around the town of Mondragon in the Basque region of Spain. It comprises work force of 103,000 or more, employed in over 260 worker-owned enterprises, of which approximately half are co-operatives (Freundlich, 2009, Mondragon, 2010). There were several institutional and structural changes through time. Some of the most important of them follow while more details may be found in the Appendix.

#### **3.1. The early years**

##### ***3.1.1. Background and Don José Maria Arizmendiarieta***

*'Mondragón is located forty-five kilometers inland from the Bay of Biscay, in the Southwestern corner of the Spanish Basque province of Gipuzkoa (Guipúzcoa). Like other Gipuzkoan towns, it sits in a narrow valley surrounded by the Cantabrian mountains' (Kasmir, 1996).* It is located inland from the two principal Basque cities, Bilbao, and San Sebastian.

In *'1941 a young Catholic Action - oriented priest named Don José María Arizmendiarieta was appointed to Mondragón'* (Kasmir, 1996). This era has been characterized as "the hunger period" as working class people were desperately poor and oppressed by unemployment, housing was rundown and overcrowded, and also there was an outbreak of tuberculosis (Whyte and Whyte, 1991).

Arizmendiarieta tried through Union Cerrajera (see Appendix 1) – a local foundry- that had invited him for an apprenticeship program, to take advantage of this invitation and include in the program boys who were unrelated to employees, something that was rejected (Whyte and Whyte, 1991). Therefore, *'in 1941 he established Escuela Profesional as he wanted to provide to local youths basic skills for entering the*

*workplace. He convinced the most talented ones, to continue their studies at university level and scientific fields relevant to the industry'* (Birlirakis, 2005).

In order to fulfill the creation of this school he organized a campaign, where citizens interested in the project could put slips of paper with their names and addresses and a statement indicating what they were prepared to contribute in money or personal services (Whyte and Whyte, 1991). Those people *'became members of the incipient organisation and gained the right to vote for the officials and determine policies'* (Whyte and Whyte, 1991). Approximately, 15% of the adult population of Mondragon responded with pledges to support (Whyte and Whyte, 1991). The school opened in 1943 with a class of 20 students. In 1948 he succeed, through a nineteenth century law, to give voice to the members of the educational organisation (see Appendix 3).

Father Arizmendiarieta paid a lot attention in the education issue. His motto was: *'by socialising knowledge, power is really democratised, which is a true reflection of the ideas behind Escuela Profesional'* (Mondragon, 2009). Through knowledge and education he built the roots for the creation of the Mondragon cooperatives.

### **3.1.2. The creation of ULGOR**

In 1956, the first Mondragon cooperative enterprise was established. The founders of the cooperative were five students of father Arizmendiarieta, who bought a business based in Vitoria, manufacturing oil stoves and ovens (Kasmir, 1996). They moved the operation in Mondragon and along with sixteen co-workers, reorganized the firm into a cooperative called ULGOR, today FAGOR Electrodomesticos (Kasmir, 1996; Birlirakis, 2005). The name of the cooperative came as an acronym of the first letter or two of those men's names: Luis Usatorre, Jesus Larraiiaga, Alfonso Gorroiiogoitia, Jose Maria Ormaechea, and Javier Ortuba (Whyte and Whyte, 1991). *'In an economy that had no precedent for such a phenomenon, they were determined to be collective entrepreneurs. There were no legal provisions for collective savings accounts, so the five men put their savings in individual accounts and trusted one another to contribute these personal funds when the time came to make the collective investment'* (Whyte and Whyte, 1991). They achieved to find funds for their enterprise through a strategy planned by father Arizmendiarieta, who suggested that they should use an old and well-established social custom, the *chiquiteo* (Whyte and Whyte, 1991).

Every day after work groups of friends gather on the streets of Mondragon and move along from bar to bar, sipping wine and conversing with the patrons and bartenders in each establishment. Through these informal channels, the five men spread the word that they were planning a cooperative firm and that they were looking for help from the community in the form of loans. Arizmendiarieta and his associates also used all their personal and organisational contacts to publicize the project. At this point they could not tell potential lenders what the firm would produce, where it would be located, or how it would be legally constituted. Nevertheless, they built on a record of successful community organizing and their great personal prestige as the first university-educated children of blue-collar workers. With nothing more to go on than the personal promises of these men, about a hundred people in the community responded with pledges, basically as an expression of faith in the five pioneers and in the guiding hand of Don Jose Maria. Including the commitments of the five founders, 11 million pesetas (about \$361,604 in 1955 dollars) was pledged-an enormous sum at this time in a working-class community of Spain.

Whyte and Whyte, 1991: 34

Father Arizmendiarieta had never a formal position in ULGOR or any other cooperative; however, he was informally an advisor for individuals or groups sharing information and ideas (Whyte and Whyte, 1991). ULGOR begun businesses with a constitution and bylaws, which with several modifications, became the model for all the worker cooperatives created subsequently (Whyte and Whyte, 1991). Further description of Ulgor can be found in Appendix 4.

### **3.1.3. Payment system**

The payment system was based on three principles: solidarity with their fellow Basques, internal solidarity and openness with regard to pay (Whyte and Whyte, 1991: 41).

The ratio between the lowest and the highest paid members was established 3:1, then in 4.5:1, to 6:1, to 8:1 and reaching approximately 9:1 today<sup>1</sup> (Whyte and Whyte, 1991; Birlirakis, 2005, Mondragon, 2009, Freundlich, 2009: 46).

The Congress has not set a maximum ratio, but rather allows member co-ops to pay senior managers up to a maximum of 70% of the market rate for her or his industry in the region or nation. This is the maximum allowed by Congressional policy, and all co-ops must, at minimum, adhere to this policy, but the actual pay rates for given co-op members are based on a ratio and are definitively set in the individual cooperative firms

Freundlich, 2009: 46

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<sup>1</sup> For analyzed transition see Appendix 5

### 3.1.4. *Caja Laboral Popular*

One of the most important cooperatives that were established in Mondragon was a credit union, Caja Laboral Popular, on Arizmendiarieta's initiative (Molina and Miguez, 2008). Caja Laboral was established, in 1959, to overcome the problem of funding and the access to capital market that historically cooperatives face (Birlirakis, 2005, Mondragon, 2009).

Arizmendiarieta believed that a cooperative could not raise equity capital by attracting private investors, that private banks would be reluctant to make loans to worker cooperatives, and that a worker cooperative would lose its independence if it was indebted to a private bank. Through intensive study of national banking legislation, Arizmendi discovered an important opportunity that had never been exploited by the private banks. A program of *ahorro olmro* (savings for blue-collar workers) empowered a bank to pay 5% above the interest rates on other savings accounts. This gave the cooperative bank an important advantage in attracting savings.

Whyte and Whyte, 1991: 49

*'Arizmendiarieta convinced the cooperatives of ULGOR, Arrasate and the consumer cooperative of "San Jose" to establish the savings bank of Caja Laboral'* (Birlirakis, 2005). *'The Caja Laboral Popular was the first second-level cooperative of the Mondragon movement'* (Whyte and Whyte, 1991). It ensured better management of workers' savings and it also provided channel resources for the development of cooperatives (Birlirakis, 2005). *'The Caja began its legal existence with two divisions: savings and social security'* (Whyte and Whyte, 1991). Caja's organisational structure differs in some points from other cooperatives (see Appendix 7).

Furthermore, Caja Laboral helps with the expansion and the creation of new cooperatives. *'Workers who want to form a cooperative and contract with the bank are not free to organize in any form they wish. It is this normative control lodged with the Caja that makes Mondragon a complex whose cooperatives are tightly bound together rather than a loose association.'* (Whyte and Whyte, 1991). Each member-cooperative has specific commitments to the bank (see Appendix 8). Its development through time has transformed and can be distinguished in four (see Appendix 9) (Caja Laboral 2011). *'The Caja's role has evolved quite significantly in the last 20 years. As the co-ops financial needs changed and the market and regulatory environment changed, the Caja came to focus more on traditional consumer and business banking'* (Freundlich, 2009).



### **3.1.5. Entrepreneurial Division**

From its beginning, Caja Laboral had been a development tool, dedicated to create jobs in cooperative enterprises (Whyte and Whyte, 1991). Consequently, when Caja took in more savings and profits than the growth in demand for loans, an active program of reaching out into the cooperatives and into the communities to locate potential groups of entrepreneurs was needed (Whyte and Whyte, 1991). In other words, they created the Entrepreneurial Division (Whyte and Whyte, 1991). Entrepreneurial Division's reorganisation and the process followed to help new businesses are described in appendix 10. In 1991 the Entrepreneurial Division became an independent organisation LKS (Whyte and Whyte, 1991).

### **3.1.6. Lagun - Aro**

Members of worker cooperatives were not considered employees under Spanish law and the national social security system did not cover them (Whyte and Whyte, 1981). A program providing them health and retirement insurance was needed (Whyte and Whyte, 1991). *'Payroll deductions supplied most of the funds for what became Lagun-Aro - the name comes from the Basque words for a protective program'* (Whyte and Whyte, 1991). Lagun-Aro in 1967 became an independent cooperative (see Appendix 11)

*'Lagun-Aro's pension system differs in a fundamental way from the Spanish public system, and indeed most public social security systems in the world'* (finding in Appendix 11) (Freundlich, 2009).

### **3.1.7. The first Cooperative Group**

In 1964, the first cooperative group, ULARCO, was created. The cooperatives Ulgor, Arrasate, and Copreci formed this industrial group and its name came from the first two letters of the cooperatives' name (Whyte and Whyte, 1991; Molina and Miguez, 2008). *'The Group will enable synergies that will dramatically increase the results of cooperatives'* (Birlirakis, 2005). Goup's creation came as a result of the cooperation of the three cooperatives and resulted in creation of two other firms (see Appendix 12) (Whyte and Whyte, 1991).

The first cooperative group revealed some challenges that the project needed to overcome in order to succeed (Whyte and Whyte, 1991). Firstly, they had to think how

these cooperatives could be linked without unduly limiting the autonomy of the individual firms. Moreover, how to balance the interests of the new firm with those of the remaining in the parent company and how to distribute profits in order no one to feel wronged (Whyte and Whyte, 1991). Furthermore, they decided that a new structure with several organisational levels was required (Whyte and Whyte, 1991). *'Membership would be drawn from the five cooperatives, but procedures also had to be established so that individual members could vote directly on any proposal to change working conditions'* (Whyte and Whyte, 1991: 60). The new structure redefined the role of some institutions (found in Appendix 12).

*'The ULARCO cooperative group was an unprecedented form of organisational development. Years later, stimulated by the Caja, most of the Mondragon cooperatives had joined to form such groups'* (Whyte and Whyte, 1991).

### **3.1.8. Eroski**

In late 60s, *'Spanish law prohibited cooperatives to sell to no members'*. For that reason, in order to achieve the volume of necessary sales to support growth, they opened membership in Eroski, the new consumer-worker cooperative, to anyone who paid a trifling amount (Whyte and Whyte, 1991). More specifically, in 1969, the cooperative Eroski as the merge of small local consumer cooperatives appeared, which played major role in evolution and establishment of Mondragon Corporacion Cooperativa (Birlirakis, 2005).

Due to competitive pressures, especially from large French chains, Eroski engaged in an expansion process almost the last two decades (Freundlich, 2009: 62). The majority of this growth has involved start-ups and acquisitions of non-cooperative supermarkets as subsidiaries of an "Eroski Group".

The need to expand quickly and substantially was pressing, and the company felt it was potentially too slow, risky and complex to undertake the expansion through the use of cooperative legal structures, especially outside the Basque Country in what was uncharted territory, both in terms of business practice and of workers' response to cooperative ideas and structures.

Freundlich, 2009: 62

*'Eroski began to address the ownership situation in its non-cooperative subsidiaries in the late 1990s by establishing a voluntary, partial employee-ownership structure for workers in these subsidiaries called GESPA'* (Freundlich, 2009: 62). Today, Eroski

consists of one of Mondragon's largest firms, chains in the Retail Group with 50,000 workers, as well as in the 12 or 15 biggest industrial and service co-ops which, together, account for over 65% of Mondragon's total workforce (Freundlich, 2009: 47). *'Eroski is currently in the process of initiating a multi-year initiative to "cooperativize" the majority of its operations'* ((Freundlich, 2009: 63).

### **3.1.9. Women Rights**

Since the creations of the first cooperative, single women were hired without any discrimination under the condition, though, to leave cooperatives when they got married (Whyte and Whyte, 1991: 41). *'This policy reflected a traditional belief that the place of a married woman was in the home and also a concern with high unemployment. Men were considered the primary wage earners and thus deserved preference for continued employment.'* (Whyte and Whyte, 1991: 41) In mid-1960s, the rapidly growing need for labor combined with egalitarian principles, women demanded, led to eliminate overt sex discrimination and this policy was abandoned (Whyte and Whyte, 1991: 41).

## **3.2. Reorganisation and restructuring**

### **3.2.1. The worldwide recession**

In late 1970s and early '80s the Mondragon Corporation experienced the biggest crisis ever had (Mondragon, 2009). *'The crisis was to cause serious difficulties in a number of co-operatives but, in spite of this, there was an increase in net employment in all the associate cooperatives as a whole'* (Mondragon, 2009). The key to overcome crisis and successfully come out of it was as they mention: *'the mutual support of the co-operatives, the generous attitude of Caja Laboral, in short: Solidarity, were the key to our strength'* (Mondragon, 2009). This solidarity has been the Group's main tool in order to face difficult and uncertain situations (Mondragon, 2009). *'Solidarity not in effort, but Solidarity based on responsibility, as Father Arizmendiarieta said: Nobody in need should be left without protection, but neither should those who act with diligence and precaution and those who show no concern for things which should not be neglected be protected without distinction'* (Mondragon, 2009).

The cooperatives succeed to survive most of the economic crisis without laying off workers, though they encouraged early retirement and transferred workers to other cooperatives. Even in the midst of crisis, the cooperatives have had lower levels of unemployment and significantly higher levels of job creation than other

Spanish firms. In the 1980s, job losses were reported for only two years<sup>562</sup> in 1980 and 44 in 1983 but the losses were recovered by job creation in each of the following years (see Whyte and Whyte 1991: 206).

Kasmir, 1996: 33

Crisis did not affect in the same way all cooperatives, as *'cooperatives that have promoted an export policy that allows them to absorb the vibrations generated by the internal market which is in deep recession, are found in a better position'* (Birlirakis, 2005).

In the mid 80s, although other countries were reviving crisis, Spain continued to lag behind with the unemployment rate reaching 20 percent and 27 percent in the Basque region (Whyte and Whyte, 1991). These facts combined with the long-anticipated entry of Spain into the European Economic Community made them to devise new policies to ensure their survival through crisis and be sustainable in both national and international competition<sup>2</sup> (Whyte and Whyte, 1991). In this period the role of Caja Laboral and Lagun-Aro appeared more crucial than ever (Birlirakis, 2005). Their contribution helped Mondragon cooperatives to cope with the recession.

### 3.2.2. *The 1974 Strike*

Since 1965 a job evaluation system was established in order to pay rates (Whyte and Whyte, 1991: 93). However, it was not unified and differed even among the ULARCO's cooperatives (Whyte and Whyte, 1991: 93). *'This complicated the problems of adjustment of workers who were shifted from one firm to another and the work of the people in personnel who were administering the diverse systems'* (Whyte and Whyte, 1991: 93). As a solution the management set in motion a major program of job evaluation (see Appendix 18) (Whyte and Whyte, 1991: 93).

This process resulted 36 per cent of the jobs evaluated asking reevaluation and the widespread dissatisfaction accompanied with the establishment of the "functional evaluations" (merit ratings) (Whyte and Whyte, 1991: 96). The main dispute many workers had was that the merit system gave supervisors power did not previously had and that the new policy was in conflict with Mondragon's basic principle: equality among members (Whyte and Whyte, 1991: 96).

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<sup>2</sup> Policies and measures for recovering crisis are presented in Appendix 17

Moreover, in 1974, this dissatisfaction led to a protest movement centered in Ularco members (Whyte and Whyte, 1991: 96). The strike involved about 400 people in Ulgor and some members of Fagor Electrotecnica (Whyte and Whyte, 1991). There was mainly a confrontation between workers and the management and the result was the expel of 17 worker members who were considered instigators and the imposition of fines of several amounts on 397 who followed them out of the plants (Whyte and Whyte, 1991: 97).

The strike resulted in chained reactions and debates both inside and outside the experiment. It also provoked the sharpest attacks yet on the cooperatives and Arizmendiarieta himself (see Appendix 19).

Debates and considerations within the experience lasted for four years and ended in 1978, with the readmit of strikers (Whyte and Whyte, 1991: 100). Management's main argument, suggested that *'the tensions and bad feelings could not be resolved otherwise, that the serious disagreements maintained divisions within the cooperative, and, equally important, that the discharges had not been well understood and accepted in the surrounding community'* (Whyte and Whyte, 1991: 101).

The four year debates led ULARCO and Ulgor in a major institutional crisis, with a general feeling that the cooperatives had to learn from the bitter experience (Whyte and Whyte, 1991: 101). There were many elaborations about the reasons and causes of the strike, as well as procedures, designed to discover what went wrong and to devise measures to avoid future breakdowns, which will be analyzed in the following chapter (Whyte and Whyte, 1991: 103).

### **3.2.3. Mondragon Cooperative Group**

In early 1980s, the successful and major role of ULARCO group had as an outcome the expansion of the group model and the creation of ten other similar groups (Birlirakis, 2005). *'People start to realize the necessity of creating cooperative groups in order to perform united actions that optimize the results'* (Birlirakis, 2005).

Nevertheless, the combination of the recovering period from the economic recession and the entrance of Spain in the EU in this time concerned the leadership of Caja and need for major organisational restructure emerged (Whyte and Whyte, 1991; Birlirakis, 2005).

Many reports and discussions were held until the final transformation (Whyte and Whyte, 1991). It proceeded through four stages, which were all guided by *'the convection was that the complex of cooperatives had to be more closely integrated if it was to compete effectively in the European common market'* (Whyte and Whyte, 1991: 201). Therefore, in 1984-85 their reconfiguration as a centralized "Cooperative Group" was established with a corresponding to a new institution the Cooperative Congress<sup>3</sup> (Cheney, 1999).

Cooperative Congress is *'made up by of the heads of each cooperative group, and each cooperative was to have at least one representative in the Congress. Larger cooperatives have more representation but not in direct proportion to their numbers'* (Whyte and Whyte, 1991:201). Its president attends meetings of the general council without vote (Whyte and Whyte, 1991). *'It was charged with approving general documents on the policies of the cooperatives, resolving social problems within the coops shaping relations with the exterior market and political entities and establishing certain targets for productivity and profit'* (Cheney, 1999)

The new arrangement weakened the autonomy of individual cooperatives and cooperative groups which were linked only through their ties of Caja Popular, and reformed to a more corporate system of governance – all cooperatives and cooperative groups are now linked through the Mondragon Cooperative Group (Grupo Cooperativo Mondragon) (Whyte and Whyte, 1991; Cheney, 1999).

#### **3.2.4. Basic Principles of the Mondragon**

In 1987, the first meeting of the Cooperative Congress took place, in which the ten basic principles of the Mondragon cooperative system were established (Cheney, 1999). The principles are illustrated above (box 1). The Basic Cooperative Principles are still in force. *'Illustration makes no attempt to apply a criterion of priority, but rather sets out to establish some form of inter-relation between them'* (Mondragon, 2009)

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<sup>3</sup> The new institution of Mondragon Cooperative Group the Governing council can be found in Appendix 20

Figure 3.1: the 10 Basic Principles of Mondragon



Source: Mondragon, 2009

The core is occupied by Education as the basic mainstream principle that feeds and feeds off all the others, and the Sovereignty of Labour, which is shielded by the other five principles of an internal nature in each individual Cooperative: Instrumental and Subordinated Nature of Capital, Democratic Organisation, Open Admission, Participation in Management and Wage Solidarity. The outer ring features the three principles that are related to the Cooperatives external projection: Inter-Cooperation, Social Transformation and Universal Nature.

MCC, 2009

## Box 3.1: Mondragon's Basic Principles

**Mondragon's Basic Principles**

- Open Admission to all who agree with the basic cooperative principles without regard to ethnic background, religion, political beliefs, or gender.
- Democratic Organisation, based on the equality of worker-owners. Workers must be members. Each cooperative is democratically controlled by one member, one vote; its governing structures are democratically controlled and responsible to the general assembly or other elected body.
- Sovereignty of Labor, which is the essential transformative factor of society. The cooperatives give full power to the owner-workers to control the co-op and to distribute surpluses.
- Instrumental Character of Capital, such that the co-op pay a just but limited return on capital saved or invested, a return that is not directly tied to the losses or surpluses of the co-op. Their need for capital shall not impede the principle of open admission, but co-op members must make a substantial, affordable and equal financial investment in the cooperative - equivalent to a year's salary of the lowest-paid member.
- Self-Management, beginning with cooperation, which involves both collective effort and individual responsibility. Democratic control requires clear information on the co-op's operations, systematic training of owner-workers, internal promotion for management positions, and consultations with all cooperators in organizational decisions that affect them.
- Pay Solidarity, both internally and externally. Internally, the total pay differential between the lowest and highest-paid member shall not exceed a factor of one to six. Externally, compensation is comparable to that prevailing in neighboring conventional firms.
- Group Cooperation on three levels: among individual co-organized into groups, among co-op groups, and between the Mondragon system and other movements.
- Social Transformation through cooperation. Jose Maria Ariznendiarrieta, Mondragon's founder, wrote: Cooperation is the authentic integration of people in the economic and social process that shapes a new social order; the cooperators must make this objective extend to all those that hunger and thirst for justice in the working world. The co-ops reinvest the major portion of their surpluses in the Basque community, including new job development, community development, social security, Basque worker solidarity, and Basque language and culture.
- Universal Nature, or the co-solidarity with all who labor for economic democracy, peace, justice, human dignity, and development in Europe and elsewhere, particularly with the peoples of the Third World.
- Education, including the commitment of sufficient human and economic resources to cooperative education, professional training, and general education of young people for the future.

Source: Morrison, 1993:32

*'The principles affirm the freedom and empowerment of working people and at the same time provide limits, characteristic of the pursuit of equilibrio, in the interest of the community'* (Morrison, 1993).

### **3.2.5. Mondragon Cooperative Corporation and 'Mondragon'**

*'Between 1984 and 1987 cooperative groups formed a loose federation. By 1990-91, what might be called a cooperative conglomerate was emerging.'* (Whyte and Whyte, 1991: 202) There was a belief that in order to survive and grow in the face of intensified international competition the Mondragon Cooperative Group should move toward a sectoral organisation in which cooperatives would operate in the same market or use technologies work together to exploit economies of scale (Whyte and Whyte, 1991).

*'There were two features principally in mind: (i) the establishment of central structures for overall governance, strategic coordination and management services and (ii) the*



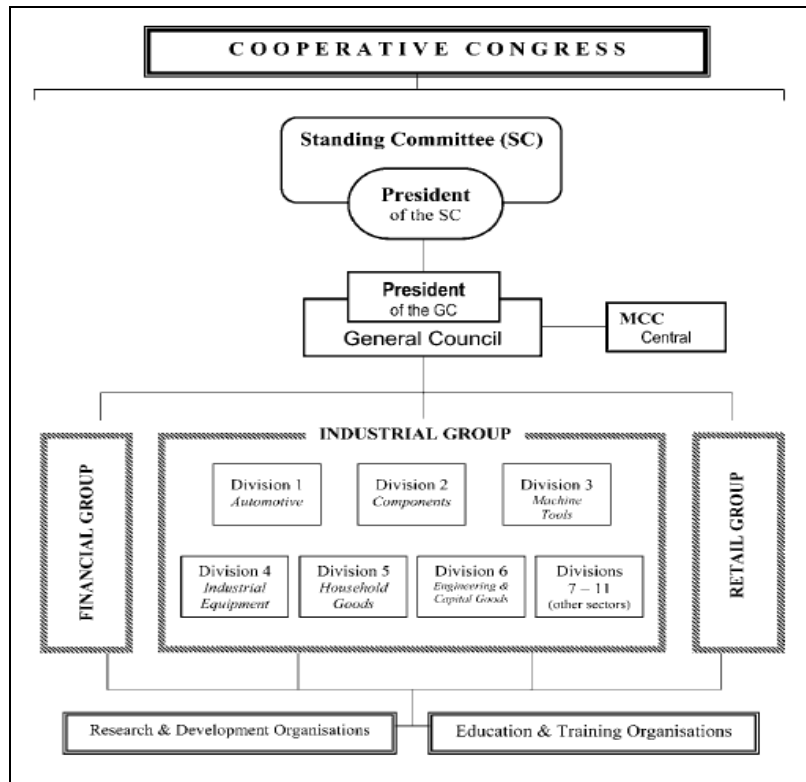
*creation of subgroups of firms, or divisions, by industrial sector instead of by geography*' (Freundlich et al., 2009). Later, in 2008, *'the named changed from 'MCC' to simply 'Mondragon', but the basic organizing principles of the MCC have, so far, largely been preserved until today'* (Freundlich et al., 2009).

Most of the cooperatives voted to be part of the MCC; however, there were also some departures, as not all cooperatives found themselves in the MCC (Whyte and Whyte, 1991; Cheney, 1999).

*'The organisational structure of Mondragon changed in the early 1990s'* (Zurbano, 2005). As it was mentioned earlier, this change became in response to new technological and market conditions in the context of the industrial recession (Zurbano, 2005). *'It involved rationalisation of product lines and markets to adapt to a new, single-brand image'* (Zurbano, 2005). Until then, the former structure was based on district groups, while now there is a configuration featuring grouping by product and market within the corporate network of Mondragon Corporation (Zurbano, 2005). *'In the old system groups and networks were formed on the basis of shared geographical location of their member co-operatives'* (Zurbano, 2005).

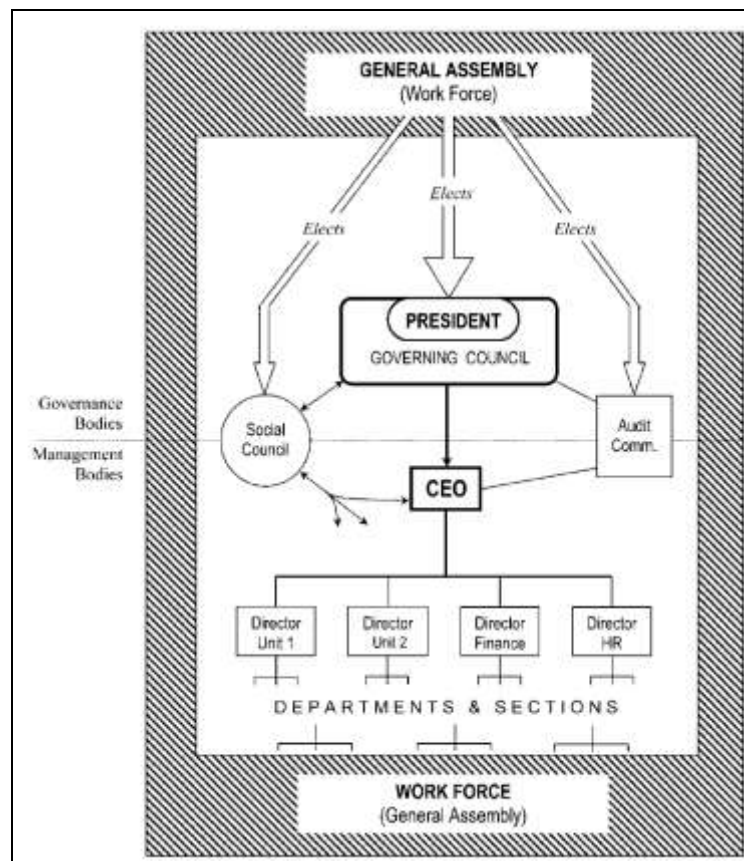
The organisational structure was finally formed as figure (3.2) shows bellow. There is the financial group, made up principally of the organisation's own bank Caja Laboral (Zurbano, 2005). The whole subsequent corporate structure is now articulated around Caja (Zurbano, 2005). It provides liquid assets for the whole corporate system. Then there is the Distribution Group, with Eroski as its flagship (Zurbano, 2005). Between the financial and the distribution group stands the industrial group which includes also the services (Zurbano, 2005). It consists of eleven main divisions and in these divisions the co-operatives are grouped according to product and market criteria (Zurbano, 2005, Freundlich et al., 2009). At the bottom of the organisation chart there is the supporting structure of training and research centres and other organisations, which provide cover for the whole co-operative consortium. All these organisations keep their autonomy within a common corporate strategy and by sharing the same management model as it was described before.

Figure 3.2: Structure of the Mondragon corporation



Source: Freundlich et al., 2009

Figure 3.3: Internal structure of a Mondragon cooperative firm



Source: Freundlich et al., 2009

The structure of a Mondragon cooperative unit – shown in figure 3.3 - is based on the 10 basic principles analyzed above (Freundlich et al., 2009). Absolute power is held on the general assembly of workers, where each one has one equal vote, regardless their position within the co-ops (Whyte and Whyte, 1991, Kasmir, 1996, Freundlich et al., 2009). It meets at least once a year and elects the Governing Council (GC) the President of the Governing Council (PGC) (Freundlich et al., 2009). The Governing Council (GC) and its president represent the Assembly between its meetings, oversee the implementation of decisions and the performance of cooperatives and discuss and decide on strategic issues (Freundlich et al., 2009). *‘The Council appoints, and may remove, the Chief Executive Officer (CEO) and must approve his or her choices for unit directors. The CEO and unit directors, together, form the Management Council, which is the body responsible for the day-to-day management of the firm.’* (Freundlich et al., 2009: 9) Members also elect an Audit Committee, which is responsible for the finances of the cooperative and a Social Council responsible for facilitate communication among the worker-members, management and the Governing Council, and generally represent frontline workers’ perspective in company decision making (Freundlich et al., 2009: 9).

*'This whole common co-operative edifice is shored up by mechanisms for intercorporate solidarity, such as the relocation of surplus labour within the corporation and the ploughing back of profits, which are the priority financial aid received by co-operatives in case of crises, through the common solidarity fund'* (Zurbano, 2005). All these mechanisms are centralised and managed by the General Council of Mondragon (Mondragon, 2009). However the cooperatives' autonomy still remained. As Zurbano (2005) and Hogner, (1993) describe:

Although they all form part of the corporate network described and share common principles, values and instruments, each co-operative is autonomous from a business viewpoint. There are no agreements for favourable treatment between co-operatives in commercial or production matters. It is not easy to strike a balance between the organisational autonomy of each co-operative and its membership of a corporation, but achieving that balance is one of the keys of the relative success of the group. The fact that relations between co-operatives in the corporation are complementary in nature helps to achieve balance. The reorganisation of the 1990s led to a policy of greater rationalisation and consistency of production in the industrial divisions.

Zurbano, 2005

*'Each one of these organisms that operate autonomously additionally performs a day-to-day, month-to-month, and year-to-year function of dramatically increasing the level of social communication within each of the cooperatives, and among the group in total'* (Hogner, 1993).

### **3.2.6. Relations with Private Firms**

As it was earlier mentioned, concerns raised about the ways Mondragon complex could grow and expand. One alternative to succeed that was through the establishment of contractual arrangements with private firms (Whyte and Whyte, 1991). Basically in 1990s many cooperatives proceeded to such arrangements.

However, according to literature reviews, collaborative arrangements between cooperative and private firms could offer advantages to both firms and challenges too. One of the challenges is found in the case of the private firm to take over the cooperative, if the majority of cooperative's wish to, something that has happened not in great scale (Whyte and Whyte, 1991).

### 3.2.7. Mondragon University

In 1997, the Mondragon University was established, starting its first courses on 1998 (Mondragon, 2009; MU, 2010). It consists of the main training centre of Mondragon, which is supported by several other vocational and polytechnic training centres (Zurbano, 2005). It is a cooperative University and its *'teaching model involves a system of relationships which, with the educational system as the central theme, aims to involve the companies and institutions in the area, in order to guarantee social accessibility, the combination of work and study, the development of research and the provision of Continuing Education.'* (MU, 2010).

The needs of the cooperatives in MCC were the driving force behind the creation and subsequent development of these training and education centres. This is perhaps the area which remains most closely oriented towards in-house demand, though there are areas where the deep roots of the corporation have resulted in training being provided also to meet the requirements of external companies.

Zurbano, 2005

Today, Mondragon University (Mondragon Unibertsitatea) has close and permanent relationships with the working world, promotes a collaborative research model and contributes to innovation<sup>4</sup> (MU, 2010).

### 3.2.8. Today's Challenges

As it was mentioned before, in order to expand and grow, Mondragon decided outside the Basque Country to purchase or create conventional companies as fully-owned subsidiaries or established joint ventures with conventional firms (Freundlich, 2009). *'The cooperatives in the group now have over 65 non-cooperative, manufacturing subsidiaries or joint ventures outside the Basque Country. A number of these are located in other parts of Spain, or other Western European countries, but most are in the transition economies of central and Eastern Europe and in emerging countries on other continents'*. (Freundlich, 2009)

This situation has emerged pressures over the last several years at many levels in Mondragon, including among senior leaders, to begin to take measures to address it (Freundlich, 2009).

So, a policy was developed and widely circulated at in 2003 requiring Mondragon's international operations to be model corporate citizens (as regards

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<sup>4</sup> MU's contribution is being described in Appendix 21

pay, working conditions, environmental practices, and contributions to the local community), and to develop plans for worker participation in three dimensions of the organisation: in decision making, in profits, and in ownership. In 2004, Mondragon composed its overall strategic plan for the period 2005-2008 and the plan called for 30% of employees in foreign operations to participate in ownership by the end of 2008.

Freundlich, 2009: 54

This goal not only has not been yet met, but in some cases has only barely begun (Freundlich, 2009: 54). This delay is due to many reasons and especially because of the current global financial crisis and recession (Freundlich, 2009: 54). Except that, *'introducing worker ownership overseas has proven very complicated on several fronts'* (Freundlich, 2009: 54). Freundlich (2009) in his thesis *'Generational Perspectives on Employee Ownership: The Relationship between Age and Satisfaction with Cooperative Ownership in Mondragon'* locates the factors that create obstacles. Some of them include the resistance to the idea among hard-to-measure percentages of shop-floor members and managers at the home co-ops in Mondragon, some believe the group should work more closely with cooperative movements in the countries where it wants to locate in order to search for compatible organisational candidates for collaboration, alliance or joint venture, while others that cooperative movements abroad have not enterprises in the particular industrial sectors of interest to Mondragon (Freundlich, 2009). In addition, many overseas operations have been established under significant time pressure, and this has made efforts to collaborate with local cooperative movements and to initiate educational programs still more complicated, while in other countries cooperative movements are only nominally "cooperative" and at times have historically been affiliated with repressive regimes, or with business and political efforts to undermine labor movements (Freundlich, 2009: 55). Another cultural and educational challenge lies in the fact that in many countries seem to have little knowledge of cooperatives or apparent interest in worker-ownership (Freundlich, 2009: 56). Finally, *'the multiple, legal and financial complications of establishing worker-owned organisations successfully overseas, that can vary from country to country and sector to sector'* (Freundlich, 2009: 56).

Another challenge deals with the non-member workers in cooperative operations at home (Clamp, 2003, cited in Freundlich, 2009: 58). The number of non-member workers has increased since 1980s (Freundlich, 2009: 58). Nowadays there is increasing reliance on non-member workers to bear the brunt of difficult economic circumstances,

something that has led to a serious and long-term debate in the cooperatives, as the unequal rights of workers is a direct contradiction of cooperative philosophy (Freundlich, 2009). The debates on the issue include various views. Some people hold the belief that non-member workers are required in order to ensure their companies' stay competitive, others supporting that a certain portion of non-member workers should be allowed under certain circumstances and others arguing that that they should under no circumstances create a more or less permanent group of second-class workers (Freundlich, 2009: 60). In the Basque country there is a cooperative law that requires a minimum of 70% of the work force of a cooperative company to have membership status (Freundlich, 2009). While this law has been violated by some cooperatives over history, Mondragon established its own stricter minimum standard to 80% in the late 1990s and early 2000s, and raised it to 85% by mid-decade (Freundlich, 2009: 60).

To help ameliorate the situation, the group also created an intermediate type of contract, the "limited duration" membership contract. This contract is offered to workers who have spent a certain amount of time as non-member employees, and provides them with member status on all issues (participation in firm governance, profit-sharing, etc.), save employment security and membership investment.

Freundlich, 2009: 60-61

As it was mentioned before, Eroski is currently in the process of "cooperativize" the majority of its operations (Freundlich, 2009: 63). *'This will be accomplished through the creation of a series of cooperative companies financed initially by Eroski, that will all be joined together in a large, second-degree retail cooperative'* (Freundlich, 2009: 63). This transformation will increase the total work force of Mondragon about 70%-75% and will be watched very closely by Mondragon cooperatives in the Industrial Group as it could serve as a model that other firms could adapt to their operations abroad (Freundlich, 2009: 63).

Another speculation lies in the centralization restructuring that Mondragon developed in 1990s (Freundlich, 2009: 63). Many worker-members have feared the potential for bureaucracy and the centralization of authority in the staff of the central departments and the groups/divisions at the Mondragon headquarters organisation, while others support that the centralization has not had a noticeable effect on co-op autonomy (Freundlich, 2009: 63-64).

Finally, a further challenge Mondragon faces is the contentious issue of compensation policy (Freundlich, 2009: 65). As it was mentioned above, today's ration 9:1 or 70% of

the market, appears to some as too high, running counter to cooperative philosophy, damaging labor relations, and promoting socioeconomic injustice and its problems in the community (Freundlich, 2009: 65). Further criticism on the issue maintains that the lowest paid workers are the ones who most need compensation adjustments and that the policy should be even more egalitarian today than it was in the early decades (Freundlich, 2009: 65-66). Nonetheless, these changes have been decided by the General Assemblies of worker-members indicating that the majority of worker-members support these decisions (Freundlich, 2009: 66).

### **3.3. Conclusions**

To sum up, the evolution process Mondragon experienced through time was introduced. It was established in a very difficult period of time succeeding, though, to maintain and be nowadays one of the most successful examples worldwide. In Mondragon's cooperative movement, father Arizmendiarieta's contribution, was highly significant. He became *'a tremendously charismatic leader in the area, with his own unusual style, decidedly not a great orator and mover of masses, but extraordinarily energetic and doggedly determined in pursuit of his goals, soft-spoken but enormously forceful and persuasive in his relations with individuals and small groups'* (Freundlich, 2009: 16). Mondragon has succeeded to adjust in changes and while it has transformed some of the factors contributing to its success, it managed to keep others more or less in place (Freundlich et al., 2009).

This developing process and facts contributing to today's Mondragon sustainability are thoroughly analyzed and combined to literature reviews of the previous part, in the next chapter.



## **4. Mondragon's success as a spatially embedded entrepreneurial organisation**

In the previous chapter a brief historical evolution and the emergence of a new business organisation was presented. In this scene the need for more innovative and entrepreneurial activity was revealed. This process has enriched literature with the phenomenon of entrepreneurial firms. In these organisations there are some spatial components which provide them with a more efficient function. In contradiction, cooperativism a non-capitalist way of production has appeared since the late 18th and 19th centuries. This way of production has widely spread worldwide and one of the most successful organisations of this type is "Mondragon". This chapter analyzes Mondragon's success as a spatially embedded entrepreneurial organisation and investigates the possibility of its transfer to other territories. So, in order to fulfill this purpose, some elements inherent to its success will be analyzed, along with those main conditions contributing to a successful and sustainable transfer.

### **4.1. Corporate governance**

Mondragon's success lies in many factors, as its innovative type of structure, its autonomy, its ability to adjust in changes and its democratic nature. However, one of the main factors promoting its sustainability lies in its model of governance.

As it was described in chapter 2, the principal agent problem appears in any contract involving asymmetric information, risk and uncertainty. Consequently, any business organisation poses this challenge, effecting its productivity and development. Even in cooperative systems, the agency problem exists, as information is not equally defused in organisations. On this issue, Mondragon appears to achieve a balance in time, which is inherent with its cooperative governance.

In the concept of participative management presented in previous section (2.2.1), cycled organisation of management was included. In Mondragon's structure, this cycled organisation appears in its structure, reducing the "distance" between the "top" and the "bottom". This is achieved mainly through the absolute power that is given in their general assemblies. Strategic issues cannot be put into practice until they are discussed

and voted by the majority of member-workers, while in the same time general assembly elects its own government bodies. Thus, every member-worker has a voice on management and government issues, while simultaneously, controls its leaders, who also control them. So, decision making is a dynamic and evolving process. The dynamic of decision making and control passes from one level to another, creating a feedback process. This process balances agent principal problem to a point, as management and strategies are controlled and information flow is available to all members.

Moreover, there are more institutional instruments providing them more control and involvement in management, strategic and production issues. The first one is the social council. *'Social Council's role is to facilitate communication among the worker-members, management and the Governing Council, and generally represent frontline workers' perspective in company decision making'* (Freundlich et al., 2009: 9). Although it was not always affective (1974 strike), it is especially important, as it *'questions abuses commitment to management'* (Whyte and Whyte, 1991). Communication is provided through management and workers' perspective involving them in the whole process of decision making. Consequently, workers do not have only voice but also an active role in decisions. Distance between "top" and "bottom" in management is not just reduced but replaced by a dynamic and evolving process involving both.

Another instrument, used to control and promote decisions, is the Audit Committee, which is responsible for monitoring co-ops' finances (Freundlich et al., 2009: 9). *'The sole, but important, function of the committee was to perform an internal audit of financial operations and of the firm's adherence to formally established policies and procedures'* (Whyte and Whyte, 1991). This instrument is also elected and controlled by the general assembly, controls management decisions on financial terms and informs worker-members on financial issues. Thus, it evolves in decision making, as it controls its financial operations and provides financial information to all members, which is crucial enough in building strategies.

Furthermore, in Mondragon network's governance, the Cooperative Congress and the Standing Committee members are elected from each of the member cooperatives and by Governing Councils of individual cooperatives respectively (Freundlich et al., 2009:

10). These instruments enhance member-workers' control and voice in an upper level, dealing with the general corporate strategy.

To sum up, all these instruments enhance the balance Mondragon achieves in the principal agent problem, providing all member-workers with information, active role in shaping and control in management and strategies.

Additionally, Mondragon's principles also contribute on this issue. Control is reinforced through principles of democratic transition and self-management that require clear information on the co-op's operations. Open Admission and Group Cooperation (see box 1) also contribute, as they ensure cooperation among all members. Education, as the basic mainstream principle, including cooperative education, professional training, and general education of young people for the future, augments information provided to all members and helps them deal with their responsibilities in decision making. Moreover, Pay Solidarity plays an important role in balancing the principal agent problem. The ratio between lower and highest-paid members is much lower than it is in private firms. It results in limiting personal interests and corruption of members with more power as higher position is not inherent with more physical gains. However, payment ratio has increased in time and may weaken further this argument in future, as it concerns today, it is an undeniable factor. In addition, given that ongoing debates take place on this issue, its future is indefinite.

In conclusion, Mondragon appears to balance agency problem, inherent to business organisation, both in structural and institutional level, providing more access in information, control and in management process.

#### **4.2. Mondragon's social embeddedness**

One of the most important factors of Mondragon's success lies in the special relations Mondragon achieved to build with its local community. From its very beginning, trust was created between Arizmendiarieta and locals, which was later transferred between "Mondragon Experiment" and local community.

The roots of this relationship can be found in the creation of Escuela Profesional. As it was described in chapter 3, locals' the enormous participation rate in money or personal

services in Arizmendiarieta's project, was the first step of what followed. Mondragon's locals trusted Arizmendiarieta in order to create a school for their children. Furthermore, Don Jose Maria's achievement to give voice to the members of the educational organisation through a nineteenth century law was an important issue, as he succeeds to use the national institutional framework for their interest.

Trust played a major role also in the creation of Ulgor. In order to fulfil the required collective investment for Ulgor, the five founders, trusted one another to contribute their personal funds, having no control on each other, as they kept their funds in different banks. Furthermore, in the same case, the contribution of an old and well-established social custom, the *chiquiteo*, was significant too, so as to collect the required amount for Ulgor. They used these informal social networks in order to spread and promote their plans to community. People's trust, was based in Arizmendiarieta's prestige, on the one hand and their own, on the other, as the first *university-educated children of blue-collar workers*. It is also noteworthy mentioning that in that time the five founders chose to become entrepreneurs, *'in an economy that had no precedent for such a phenomenon'* (Whyte and Whyte, 1991).

Caja's Laboral significance was enhanced through the use of another institutional framework, *ahorro olmo*, a savings program for blue-collar workers which, as it was described in the previous chapter, was crucial for attracting savings and promoted Caja Laboral's establishment.

Consequently, in Mondragon's succeed establishment, social capital – social relations were enhanced with trust Arizmendiarieta and his students achieved to earn in Mondragon's community, led to the creation of the "experiment" and the establishment of collective action. Moreover, informal social networks and the institutional framework were used, empowering its creation and evolutionary process.

However, Mondragon's greater success lies in its ability to create new institutions for its support (Lizarralde, 2009). As it was described in the previous chapter, Mondragon has constructed many training and financial support institutions. Education, being the core of the "experiment" has proceeded in time constructing today a training system with multiple institutions, promoting education, training and research. The whole system finds its roots in the school for blue-collar workers' children, which reformed in a

Polytechnic School later. Then, it is highlighted with the creation of Alecoop, Ikerlan and Mondragon University. This system helps local people providing them access to knowledge, despite their social class. This was mainly established through the creation of Alecoop which gives students coming from low economic strata the opportunity to continue their studies as they could work in the cooperatives at the same time (Whyte and Whyte, 1991). So, these students every day can work for four hours in the cooperatives and four hours will attend classes, while at the same time they have the right to participate in cooperative's management (Birlirakis, 2005). It is also enhanced through the possibility provided by Mondragon University to its students to work in order to pay for their education (MU, 2011). Furthermore, all students of Mondragon University finish their studies with a project in a company (MU, 2010). Consequently, on the one hand, Mondragon's training institutions contribute in local educational level and on the other, give the opportunity to local people to interact in practice with the cooperative movement.

Caja Laboral's contribution is highlighted in this issue as well. *'Caja Laboral annually distributes the equivalent of 11% of its profits to its society in a direct and close way'* (Caja Laboral, 2011). This contribution is specially depicted through its Education and Promotion Fund, funding in research, promoting employment, culture and charity projects (Caja Laboral, 2009). They contribute about 15% of this fund in creating and strengthening employment and give another amount of this fund in promoting entrepreneurialism, one way of creating wealth and wellbeing for their society (Caja Laboral, 2009). *'In training and research, as it is a priority for development and progress in their society and in charity projects intended to fight drug addiction and social marginalisation, integrating disadvantaged people and other humanitarian initiatives, strengthening volunteering'* (Caja Laboral, 2009). A special contribution given in Basque society from Caja lies in funding to promote Basque Language and Culture (Caja Laboral, 2009). They support to institutions and initiatives that aim to strengthen and standardise the Basque language and to other initiatives promoting the Basque culture (Caja Laboral, 2009). Consequently, Caja appears to contribute significantly to its community, promoting and strengthening its employment, its educational level and its Basque identity.

In this scene, Mondragon's basic principles should be noticed, as they reflect their interaction with community especially through their principle: Social Transformation through cooperation (box 1). Arizmendiarieta wrote: *'Cooperation is the authentic integration of people in the economic and social process that shapes a new social order; the cooperators must make this objective extend to all those that hunger and thirst for justice in the working world'* (Morrison, 1993: 32). This is promoted through the above description of Caja's social funding and is further enhanced by their principles of Instrumental Character of Capital and Education (box 1). Through these two principles emphasis is given to labour and education, being primary and capital becoming an instrument (Freundlich, 2009). Furthermore, their deep connection with their community lies in their own statement: *"The co-operative movement will be a fleeting phenomenon if it is not planned and developed by our society as a whole with its roots in education and in social and economic relations"* (Mondragon, 2009). Today, Mondragon constitutes one of the most important major productive agents in the Basque Country, with approximately work force of 103,000 or more (Mondragon, 2009, Freundlich, 2009). In Mondragon, Basque nation saw its national mode of production (Heiberg, 1989: 225).

*'At the same time, the Basque regional government's work in supporting the cooperative model and creating a specific department to deal with cooperative issues should be strongly stressed'* (Lizarralde, 2009). However, how soft and hard institutions in Basque Country have transformed to empower Mondragon's cooperative movement need further research and are not included in this analysis.

### **4.3. Leadership Style**

A key element in Mondragon's successful history lies in the leadership style provided by Arizmendiarieta. As it was mentioned before, he became a tremendously, charismatic leader with an unusual style. He wasn't a great orator and mover of masses, but he was determined in pursuit of his goals, soft-spoken and enormously forceful and persuasive in his relations with individuals and small groups (Freundlich, 2009). Through the historical review of Mondragon, he seems to have a catalyst role, not only in the creation of the cooperative movement, but also in the whole evolutionary process of the "experiment". *'He is described as being at once a Catholic and social science intellectual, as well as a detail-oriented, goal-oriented pragmatist'* (Freundlich, 2009).

Although he never had an institutionalized position in Mondragon, he always had an active role, in advising, helping and persuading them. He succeeded in introducing them to collective thinking and practice, from multitude of educational activities, formal and informal for children and adults in a wide variety of areas; religious, technical, cultural and recreational (Freundlich, 2009). *'He was a committed follower of Catholic Social Doctrine, and based on his reading in this tradition, as well as in social science generally, he gradually introduced these groups to ideas that questioned conventional forms of organisation and socio-economic relations'* (Freundlich, 2009: 16). He did not control them but instead he always advised and supported them. This unique style of leadership he provided, propelled people of Mondragon, to take responsibilities and initiatives to further the "experiment". Arizmendiarieta became a leading figure enhancing trust and introducing people of Mondragon, prosperity coming from building trust.

Moreover, in Mondragon's history, many people take the lead and promote fundamental steps in Mondragon's transformation in time, as in the creation of important cooperatives and in their reorganisational reform. The leadership issue appears crucial enough in many periods of time, one of which lies in 1970s, when strike burst in cooperatives. It could be concluded that Mondragon's system with its cooperative values and collective action and thinking, provides creation of leading personalities with strategic management role.

However, this analysis cannot be placed here, still, remains one important field for research and analysis.

#### **4.4. Mondragon's Space-Specific**

In the previous sections some of the main factors contributing to Mondragon's sustainability were analyzed. Here we focus on how spatial specificity of Mondragon influenced its establishment and success.

Many attribute this success on the socio-cultural identity of Basque people. Basques' long history, participant and democratic nature has formed a strong national identity an undoubtedly important cultural factor that could not be easily replicated elsewhere (Sperry, 1985). As it has reported, they have created a strong "Basqueland" succeeding

to endure its borders because they are cultural, not political or artificial (Kurlansky, 1999). Literature indicates that they have always drawn and assimilated immigrants, and there is no formal distinction between Basque and non-Basque people (Bradley and Gelb, 1982, cited in Sperry, 1985). Furthermore they are characterized as productive, industrious people, with a strong working class and labour movement (Sperry, 1985; Whyte and Whyte, 1991; Kasmir, 1996). All these factors contributed in creating a strong unique identity and assisted in the creation of the cooperative movement.

A factor contributing to its uniqueness lies in the socio-economic environment in which cooperatives were created. Spanish civil War, had led Basques' to be politically repressed and economically exploited (Sperry, 1985). This era has also been characterized as "the hunger period" as working class people were desperately poor and oppressed by unemployment, housing was rundown and overcrowded, and also there was an outbreak of tuberculosis (Whyte and Whyte, 1991). Further, they were unable to wage successful resistance through a labour movement, as the experience they had from when the strike held in Union Cerrajera (a large foundry and metalworking company founded in the area) had resulted in failure and blacklisting of 33 workers<sup>5</sup> (Sperry, 1985; Whyte and Whyte, 1991). In addition, access to the minimal educational facilities available was limited to the sons of Union Cerrajera's privileged personnel, so, no channel for social mobility existed (Whyte and Whyte, 1991). All these factors, although seem to be an obstacle, combined with their national identity described above, have led locals to their own collective strength in small cooperative businesses (Sperry, 1985).

However, *'Mondragon is not robbed of general significance because of the role of either the Basque culture or Don Jose Maria'* (Johnson and Whyte, 1977, cited in Sperry, 1985).

In contrast, it may be argued that it contributed in building an advantageous environment – their own spatial specificity, promoting Mondragon's establishment. Great effort has been put into creating a whole nexus that takes into consideration financial aspects, research, promotion of new business activities, education and health care. This environment was first achieved through the creation of ULARCO. As it was

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<sup>5</sup> See Appendix 1 for details



mentioned above, this organisational decision came as a natural result of their existing cooperation and was made to enable synergies so as to increase their economic results. The success of this model was further developed in mid-1950s with the creation of Mondragon Cooperative Group (MCC later and Mondragon today). They also decided to divide the groups based on their industrial production and not based on geographical location, as it was until then, in order to achieve even better results (Birlirakis, 2005). This clustering process has created a "supra-structure", a widely network, that enables synergies, providing economic growth. This "supra-structure" is enhanced by a solid-four pillar structure of financial, training, research and enterprise promotion support (Lizarralde, 2009). This has led to development of not just the cooperative movement, but of the entire local territory.

Moreover, the Entrepreneurial Division contributes especially in building and enhancing its spatial specificity, as identifies possible entrepreneur groups to join the experiment (Whyte and Whyte, 1991). But the main catalyst of Mondragon's structural reproduction appears to be Caja Laboral, which in order to fund a firm the cooperative structure is a condition.

However, the main catalytic factors enhancing the whole network are education and innovation. The evolving educational system, described above, gives support and satisfies the demands of the cooperatives (Lizarralde, 2009). At the same time, inter-cooperative solidarity, creates innovation and internationalization that the individual cooperatives would have found difficult to tackle alone and enhances the process of Mondragon's development (Lizarralde, 2009). *'Innovation comes from relinquishing control, from liberating people from all the restrictions that inhibit their ability to think, decide and act'* (Lizarralde, 2009). Innovation flows and diffuses in the whole supra-structure, and is enhanced by the liberty given to workers to have active role in management and the flexibility provided to cooperatives to listen to people (Lizarralde, 2009). Innovation is a key element in cooperatives, as they are free to explore new possibilities, choose new projects and new reforms in structural and institutional level as well.

#### **4.5. Challenges to principles and values**

Mondragon's sustainability comes as a result of the balance they succeed in its "mix-purpose" to promote business activity and in the same time preserve their cooperative values. The organisational democracy, described above, enhances the process of achieving this balance. However, many factors in time challenged and still challenge their cooperative nature, presented in chapter 3.

The first major challenge Mondragon faced was the 1970s recession. Many problems appeared, forcing them to take difficult decisions in order to overcome it (see Appendix 17). These decisions were made in order to protect cooperatives and worker members as well, something that was achieved successfully as they had small losses. In this period, the role of Caja Laboral and Lagun-Aro was critical. Decisions taken, to support employment and social welfare, indicate their commitment to their values and principles. In a period of financial downturn, people and labour still retained their primary objective.

In 1974, a new challenge occurred, resulting in the outbreak of a strike. This episode was crucial enough, as it consists of a basic challenge in experiment's identity and balance. A great debate was held in Mondragon. During the debate, strikers argued that the Social Council failed in its purpose and strike was their own way to show their dissatisfaction, while management claimed that the democratic channels and structures, available for dialogue, were not used (Whyte and Whyte, 1991). The whole issue and the long time of reflection (10 years), indicates questioning and dissatisfaction inside and outside the experiment. It provoked chained reactions and debates, as well as the sharpest attacks yet on the cooperatives and Arizmendiarrrieta himself; most hostile were those of ETA and the Catholic Church (see Appendix 19). The core of these attacks was the workers' identity in Mondragon. Some critics support that strike came as a result of employer-employee relation that was transformed to management-worker relation in Mondragon. They argued that working class deceives itself, trapped in its own laws (the laws of the capitalists) against which they should fight (Kasmir, 1996).

For the first time there were two sides calling one another "those from the top" and "those from the bottom". Therefore, strike reflects a challenge in the cooperative idea, while in the same time, the ongoing process following the 1974 strike reflects their need to preserve their values.

People were divided. On the one hand there was wide dissatisfaction and on the other the strike was considered a betrayal of the cooperative movement. In addition, Arizmendiarieta's response, pointing the problem on bureaucracy and functionary spirit, indicated that more attention had to be paid to the issue. *'The group's conclusions raised questions about the way management had handled the conflict. They recognized that the strikers had real problems and that the organs of participation were not functioning effectively at the time'* (Whyte and Whyte, 1991: 101). So, *'a series of discussions, centered on questions of internal policies and procedures, designed to discover what went wrong and to devise measures to avoid future breakdowns'* (Whyte and Whyte, 1991: 102). Permanent Central Commission pointed as one of the reasons the techno-entrepreneurial evolution of Mondragon and the inability of worker-members to respond to their dual role (Whyte and Whyte, 1991). Another one is found in the difficulty of member-workers to balance between functions and responsibilities (Whyte and Whyte, 1991). Another reason was identified in the centralization of decisions at high levels of hierarchy and on the impact of technical specialization. Whyte and Whyte, (1991), claim that the expansion of Mondragon attracted many people aspiring to participate in economic benefits but they didn't have the cooperative culture, the experiment had until then. Finally, the lack of dialogue between members and institutions also played a key role (Whyte and Whyte, 1991: 105). This experience highlighted the need for transforming social councils, through new socio-cultural values (Whyte and Whyte, 1991: 105).

So, sectoral social councils were empowered, through training of the members in organisational methods (Whyte and Whyte, 1991). *'The role of the administrative secretary was defined as being a facilitator of communication rather than an organisational leader'* (Whyte and Whyte, 1991: 106). The Social Council was established as an advisory and consultative body to management and the governing council, with its scope being to provide guidance in everything related to accident prevention, safety and health on the job, social security, systems of remuneration, administration of social services and personal assistance (Whyte and Whyte, 1991: 106-107). Furthermore, power of worker members was increased, through the establishment of mini-councils the *coniejillos* (Whyte and Whyte, 1991: 104).

The years following the strike (1974) coincided with the end of the Franco regime, something that revealed a new challenge. Their relations with external organisations,

such as political parties and labor unions. *'Many of the members of Mondragon became involved in political parties after the dictatorship, and the values on which the complex were built supported the labor movement'* (Whyte and Whyte, 1991: 108). This was something new for the experiment as it was the first time that its members were openly supporters of *groups of organized opinions*, as they came to be called (Whyte and Whyte, 1991: 108). As in all matters, there were opponents on accepting external organisations, supporting that a change like that could polarize the economic and social activities of the cooperatives and lead to difficult confrontations (Whyte and Whyte, 1991: 109). The new policy in the context of the values of the cooperative complex was as follows:

The cooperative community must be open, by definition, to all creative and efficient ideas for improving both economic and social management, received from whatever quarter. Therefore, we see no obstacle to providing these organisations with opportunities to make their contributions within the cooperative. If experience demonstrates that in practice they do not serve these ends, either for reasons of the existing culture or for the prevailing interests of these groups, there will be time to make a correction and eliminate this regulation.

ULARCO PCC, 1980, cited in Whyte and Whyte: 110

So, ULARCO decided to provide to these groups the right for proposals directly to PCC of ULARCO, to place notices on official bulletin boards and to have space in management buildings for meetings after working hours (Whyte and Whyte, 1991). Since 1981, *'any group wishing to be recognized within ULARCO could easily obtain such recognition'* (Whyte and Whyte, 1991: 111).

In these cases, Mondragon faced two different challenges. In both cases cooperative values were challenged. However, the solutions given were fundamentally different. In the first case the solution was given through structural changes – reforming social council - while in the second one change in movement's identity was held. By accepting and giving active role to external groups, the challenge provided a new perspective, enhancing their principle in Open Admission.

Today Mondragon faces further identity challenges. The first one lies on the more integrated restructuring change Mondragon made in 1990s. Opponents fear the potential for bureaucracy and the centralization of authority in the personnel of central departments and groups/divisions at Mondragon headquarters, while many others support that the centralization has not had a noticeable effect on co-op autonomy (Freundlich, 2009: 63-64). However, there is not accurate picture on the issue and

further research is needed in order to be clarified. Still, many believe that *'the problem lies not principally at the center, but with a certain portion of workers and managers in member cooperatives'* (Freundlich, 2009: 64). In addition, this issue is directly linked with the commitment of members to cooperative ideas and the level of their satisfaction (Freundlich, 2009).

There is also the timeless debate on compensation policy (Chapter 3 and Appendix). *In the complex context of cooperative philosophy, shifting social reality and members' perceptions of these, compensation policy remains a contentious issue'* (Freundlich, 2009: 65). Opponents of contemporary compensation policy believe that it is running counter to cooperative philosophy, damaging labor relations, and promoting socioeconomic injustice and related problems in the community, while supporters claim that ratio in Mondragon is much lower compared to private firms and also promotes and gives motive to management and workers in general (Freundlich, 2009: 65-66). However, this issue is frequently debated and this will also be the case on in the future (Freundlich, 2009).

Finally, a great challenge involves non-cooperatives the experiment developed in time. The opportunity private contracts gave to Mondragon, has several years now created concerns of the identity of Mondragon. Many believe that private firms abroad, draw Mondragon away from their cooperative idea. So, many pressures have led to the decision of cooperativizing business overseas. In contrast, there are worries related to *'plain economic self-interest, social and economic implications of failure overseas, fear of unwittingly financing and creating competitor, from the weight of other pressing business priorities, and from cultural and perhaps even racial prejudices'* (Freundlich, 2009: 54). However, most of them recognize that the process of *cooperativization* will take many years to develop, adapt and implement in different cultures, in different parts of the world, mainly because Mondragon still lacks substantially in inter-cultural experience (Freundlich, 2009: 56). However, as Freundlich, (2009: 56) points: *'Whatever happens in coming years, this thicket of thorny and interwoven questions forms part of the Mondragon cooperative experience, particularly the experience of the last decade'*. Consequently, identity challenges are currently being held and a first step in transferring Mondragon's cooperative movement is attempting.

There are also concerns and questions about the non-members in home co-ops. *'The increasing reliance on non-member workers to bear the brunt of difficult economic*

*circumstances has led to a serious and long-term debate in the cooperatives'* (Freundlich, 2009: 59). However, the unequal rights between members and non-members (mentioned in previous chapter) are thought to come against principles and values of Mondragon. This debate has appeared in various times the last two decades and now Eroski, is expected over the next several years, to transform approximately 35,000 of its 50,000 workers who are non-member employees to worker-members (Freundlich, 2009: 63). It's worth mentioning here that there are serious concerns about the "cooperativization" of the seasonal jobs (Freundlich, 2009: 59-60). Although this transformation is complicated and will take many years to be completed it will form Mondragon's future character and will place them a step forward to their cooperative values. *'Transfer processes must be understood as processes of networks of various and different individuals, with different 'social', cultural, political positions and interacting, sharing, discussing, adapting and building together new knowledge'* (Larrasquet and Dupouy, 2009). *'Transfer issues need be understood as socio-cognitive constructions'* (Larrasquet and Dupouy, 2009). Another important element is that transfer should be controlled as it can be seen as a learning process requiring real collaboration (Larrasquet and Dupouy, 2009). However, this control should be largely in the partner receiving the "wisdom", in order to ensure transfer processes are congruent with the needs of the partner who is in position for development (Larrasquet and Dupouy, 2009). So, the challenge of transferring or following Mondragon's lead lies firstly in the hands of those choosing to adapt or be inspired from the experiment.

All these challenges debating combine the future of Mondragon.

The future of worker-owned enterprises and the potential these firms represent in terms of the distribution of wealth and power, the strengthening of democratic principles and practices, and the improvement of enterprise performance all depend as much if not more on commitment as they do on satisfaction.

Freundlich, 2009: 257

However, the nature of the Mondragon movement poses continues challenge, as its structure and nature can run the movement counter to cooperative philosophy. All its nature is based on the commitment its members have to cooperative ideas as well on their satisfaction of the model (Freundlich, 2009). So, especially today, when most of the generation that founded and consolidated the Mondragon firms is either in retirement or nearing it, the future lies on younger generations' perspective on cooperative ownership (Freundlich, 2009: 258). However, whatever happens in future:

The Mondragon co-operatives have altered the traditional, capitalist system of business ownership and employment relationships in fundamental ways. Despite important shortcomings and challenges, cooperative ownership in Mondragon offers an economically viable alternative to the conventional and often criticized corporate model of business practice and economic development, an alternative that is comparatively quite democratic, participatory and egalitarian. Many, both inside and outside Mondragon, believe it is an alternative worth preserving.

Freundlich, 2009: 258

## 5. Conclusions

In this dissertation the case study of Mondragon Corporation as spatially embedded entrepreneurial innovation was analysed. At the outset, the emergence of a new business organisation and the phenomenon of entrepreneurship were introduced, along with spatial components inherent to these organisations' functional enhancement. Furthermore, an alternative way of production, cooperativism, was presented in its basic principles and values. In the framework of cooperativism, the Mondragon experiment was revealed through its historical development. Then, some of the most important factors contributing to and challenging its sustainable development were analysed in order to investigate its spatial embeddedness and the main conditions for a possible sustainable transfer outside the Basque territory.

Multiple factors reflect Mondragon's spatial embeddedness. Its unique corporate governance provides to all worker-members information, active role in shaping and control in management and strategies. It consists of an alternative and sustainable governance model, where workers are responsible for their own decisions.

It succeeded to create strong bonds with local community. Trust and social relations formed the bedrock of collective action, which combined with the use of the institutional framework, led to the economic growth of Mondragon's network in the Basque Country. In reverse, Mondragon feeds back to the Basque region, contributing to its regional development, strengthening local welfare and Basque culture and identity.

On the one hand, Basques history and identity along with the socio-economic environment of Mondragon's creation, led to the cooperative movement. On the other hand, their cooperative values and principles, along with the supporting instruments they created, allow the replication of Mondragon's structure and promote its development.

However, being both a business organisation and a cooperative movement, committed to its cooperative values, carries ongoing challenges and debates. Its greater challenge today lies in their project of "cooperativize" all their non-cooperatives and opens the



whole dialogue on the possibility of a successful and sustainable transfer. However, this process *'should be understood as socio-cognitive constructions'* (Larrasquet and Dupouy, 2009) and will take a long period of time, as it consists of a learning process.

All these elements contribute to Mondragon's success and sustainability and become an inspiration and guide for new cooperative movements. However, further research should be conducted in investigating the extent to which informal (soft) and formal (hard) institutions in Basque Country have transformed in order to empower Mondragon's cooperative movement and to the leadership style promoted by Don Jose Maria and to which extent was transmitted or reformed and replicated in the movement. Future efforts, marked by "cooperativization" will reveal further questions and perspectives in Mondragon's transfer to other territories.

## **Appendix to Chapter 3**

In chapter 3 some of the most significant formations and cooperatives composing Mondragon were presented. However, some more details in the way they were constructed, some missing details in their structural and organisational choices along with the creation of some co-ops will be further described here.

### ***1. Background of Mondragon***

As Whyte and Whyte (1988) describe in their book *"Making Mondragon"*, at the close of the Spanish Civil War Mondragon was *'a small and inconspicuous town (population of 8,645 in 1940), nestled in a narrow valley surrounded by steep hills and mountains and had little space for industrial expansion or population growth'* (Whyte and Whyte, 1991). Nevertheless, it did have a centuries-old industrial tradition that helped industrial development, as the famous swords of Toledo were made there (Whyte and Whyte, 1991).

*'From the early years of the twentieth century, Mondragon had been dominated by a large foundry and metalworking company, the Union Cerrajera. Stock in that firm was closely held by family and friends, and no one outside the circle could hope to rise above a first-line supervisory position'* (Whyte and Whyte, 1991). In 1916 a bitter three-month strike burst that ended in complete defeat for the union (Whyte and Whyte, 1991). When the strike finished, 33 workers lost their jobs presumed to be ringleaders, something that cost them not to be able to work in no other of the forty factories and workshops in the area, because the firms maintained a common blacklist to exclude "troublemakers" (Whyte and Whyte, 1991). *'As late as the 1950s, the blacklist against labor activists was still maintained by Mondragon employers'* (Whyte and Whyte, 1991). As Don José Maria, the founder of the Mondragon cooperatives, quoted: *'This was an active and restless town even before the war, and there was a considerable socialistic orientation. There had also been serious social tensions'* (interview from Whyte and Whyte, 1991). Mondragon was a working-class town. *'Education provided no channel of social mobility. The Union Cerrajera supported a training program, but enrollment was limited to sons of company employees. Higher education was out of the question. No son of a Mondragon worker had ever gone to a university.'* (Whyte and Whyte, 1991)

## **2. Don José María Arizmendiarieta**

Don José María Arizmendiarieta joined the armed resistance against Franco and was imprisoned and faced the death penalty, something that managed to avoid as he stated that he participated in the Basque army as simple soldier and not in the nationalist forces (Whyte and Whyte, 1991). After his release he returned to Vitoria to finish his studies for the priesthood - that had begun before war releases (Whyte and Whyte, 1991). *'As he was approaching his ordination, he appealed to the monsignor to allow him to study sociology at the University of Louvain in Belgium. The monsignor denied his appeal and dispatched him to Mondragon with no other assignment than to serve under the more senior priests of the parish'* (Whyte and Whyte, 1991: 28).

There, Arizmendiarieta *'organized a Young Catholic Workers study circle for teenage apprentices in a local factory'* (Kasmir, 1996). As Whyte and Whyte write:

In his pastoral work, Don Jose Maria gave special attention to the revival of two moribund church organisations, one for blue-collar youth and the other for the families of his parishioners. He worked with and through the church organisations to establish a medical clinic. He also worked to establish an athletic field and a sports league, beginning with soccer. These early organizing activities produced a social base for all future institution building and made it possible for Arizmendiarieta to concentrate on his principal concern: providing the people of Mondragon with the technical skills necessary to support a social vision

Whyte and Whyte, 1991

## **3. Escuela Profesional's organisation**

As it was mentioned before, *Escuela Profesional* opened in 1943 with a class of 20 students and in 1948 voice was given to its members, distinguished in four groups:

- i. any individual who had expressed the desire to join the league;
- ii. active members who contributed either monthly dues or a service, including teaching;
- iii. sponsors who gave annual financial contributions of at least 1000 pesetas (about \$89 at the 1948 U.S. exchange rate; most of the small enterprises in Mondragon were sponsors); and
- iv. honorary members (local authorities, who were legally required to be represented in any association).

Each membership group elected ten representatives to a general assembly, which in turn elected the fourteen-member school board. Six board members

were representatives of contributing enterprises, and one was the mayor of Mondragon. The chartering of the school, the Escuela Politecnica Profesional, and the presence of the mayor on its board indicated that the new cooperative organisation had gained at least grudging acceptance from political authorities. It was not until 1971 that the Union Cerrajera closed its apprenticeship school and began making annual contributions to the Escuela Politecnica.

Whyte and Whyte, 1991: 30

#### 4. Ulgor's structure

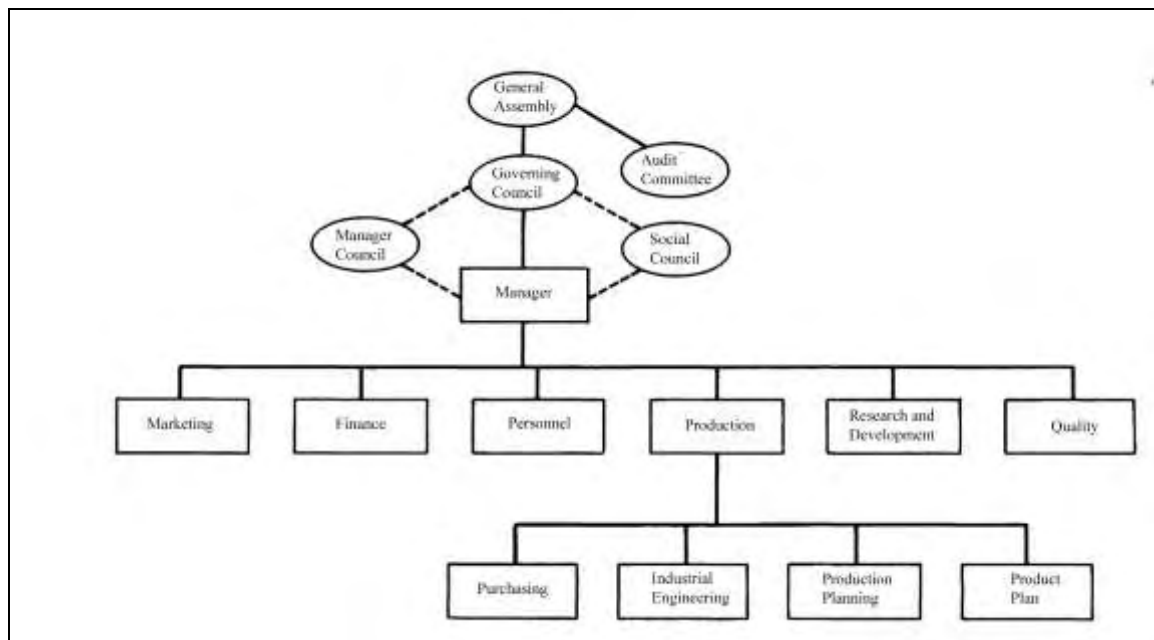
At its core, as Molina and Miguez (2008) claim, was:

The basic principle of transforming society through co-operation, something Arizmendiarieta had promoted throughout 14 years of social work. There had to be co-operation at every level: between social classes, institutions, generations, public and private sectors, believers and non-believers, priests and laity, Basque and Spanish nationalists, left- and right-wing parties, liberals and Marxists, employers and employees, men and women. This required a religious sensitivity that could soften hard-line ideological or patriotic positions, unite ideals and encourage the sacrifice of individual longings for the good of the community of workers and the community at large.

Molina and Miguez, 2008

The organisational structure of the cooperative was built as figure (A.1) shows:

Figure A.1: Structure of Ulgor



Source: Whyte and Whyte, 1991: 36

*General Assembly:* 'Ultimate power was given in the general assembly of the cooperative (asamblea general), in which all members of the firm have not only the

*right to vote but the obligation*' (Whyte, and Whyte, 1996). *'Each cooperative member has one vote in the Assembly, regardless of his or her position in the firm'* (Kasmir, 1996). It meted at least annually and meetings could be also called by the governing council of the cooperative (*junta rectora*) or by the one-third of the members (Whyte and Whyte, 1996).

*Governing council:* It was the top policy-making body of the cooperative elected by the workers – members, who had each one vote (Whyte and Whyte, 1991; Kasmir, 1996). The council meeting could be attended by key executives, who are not members (Whyte and Whyte, 1991). *'Mondragon distinguishes between governance and execution or management of operations'* (Whyte and Whyte, 1996). Members were elected for a four years term every two years, having no bonus for their responsibilities, but they kept their regular salaries (Whyte and Whyte, 1996). *'The council had overall responsibility for management policies and programs. It selected the manager who served for a four-year term unless he was deposed by the council. It also appointed his immediate subordinates'* (Whyte and Whyte, 1996).

*Manager:* He was the chief executive officer of a cooperative, being the most influential individual in a cooperative (Whyte and Whyte, 1996). However, he was under the general control of the governing council\_having voice but no vote in its meetings (Whyte and Whyte, 1996).

The manager is expected to be a strong executive but also to work in close consultation with department heads. He or she is consulted by the governing council regarding the replacement of department heads but does not make such key personnel decisions, which are reserved for the governing council. The manager may be reappointed; but his performance must first be reviewed by the council.

Whyte and Whyte, 1996: 37

*Audit committee:* *'It was required by law, consisted of three people elected by the members of the cooperative. The sole, but important, function of the committee was to perform an internal audit of financial operations and of the firm's adherence to formally established policies and procedures'* (Whyte and Whyte, 1991).

*Management council:* It was created by ULGOR, and consisted of the manager and chief department heads (Whyte and Whyte, 1991). *'It was a consultatory body to the General Manager'* (Kasmir, 1996)

*Social council*: *'The first major change in the design of Ulgor involved the creation of a social council'* (Whyte and Whyte, 1991). While earlier publications thought that the social council was an instrument established from the creation of ULGOR, now literature indicates that it was a reform of the social committee – a precursor of the social council- which it was established in late 1950s (Whyte and Whyte, 1996). As Gorrnogoitia emphasized – stated in the book of Whyte and Whyte (1991), the social council *'was not intended to be a countervailing power (contra-poder) in relation to management. It should not make demands on management, but rather should help integrate the cooperative by furthering the communications process'* (Whyte and Whyte, 1991). However, it questioned abuses commitment to management (Whyte and Whyte, 1991).

Following the ULGOR's lead some other industrial co-operatives began to appear: Arrasate in 1956, Copreci in 1962, Comet in 1963 and Ederlan, in 1969 (Molina and Miguez, 2008). *'The Ulgor statutes were approved in April 1959, launching a socio-entrepreneurial movement that in 1967 would be labelled the Mondragon co-operative experience'* (Molina and Miguez, 2008). All workers participated in the company were partners with an equal share of capital, thus becoming its owners (Molina and Miguez, 2008). They *'operated on values such as co-operation, self-management, solidarity, hope, sacrifice, high personal standards, responsibility, authority and democracy. These were grouped into three categories in the statutes: social, economic and labour issues'* (Molina and Miguez, 2008).

ULGOR's success is found in the fact that when it started businesses it met a market closed to foreign trade, something that was extremely useful for it, as it could absorb all domestic production (Birlirakis, 2005). *'So, "license to produce a product"<sup>6</sup> was a key point for its entry and consolidation in the domestic market as the existing knowledge did not allow production of new products'* (Birlirakis, 2005). However, what in first place was an advantage became a disadvantage and a limit afterwards, hence, an R&D department was established very soon, to overcome this problem (Birlirakis, 2005).

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<sup>6</sup> With the *license to produce a product* a Spanish company was able to produce a product of a foreign "inventor" company. The Spanish company was committed to give a portion of its profits to the "inventor" company and not to trade this product abroad (Source: Birlirakis, 2005).

### **5. *Wage and salary levels***

The payment system was based on three principles as follow:

(1) solidarity with their fellow Basques, which meant that the starting rate for unskilled workers was fixed at approximately the prevailing rate for similar jobs in the private sector; (2) internal solidarity, which meant that the need to reward superior performance and service had to be balanced against the need to minimize status differences based on pay; and (3) openness with regard to pay, which meant that information on all salaries was available to all members.

Whyte and Whyte, 1991: 41

Over time some executives were leaving the cooperatives for other Spanish private firms where the salaries were over sized and more profitable (Whyte and Whyte, 1991). This, combined with a growing belief that the three-to-one ratio was an anachronism among managements, resulted in the increase of ratio to 4.5 to 1 where it remained until 1987, when it was changed to 6 to 1. In 1990s, after the creation of the Mondragon Corporation and in view of the growing complexity of both organisation and day-to-day activities of its Cooperatives, they decided to implement a salary range going from 1 to 6, reaching level 8 in certain exceptional cases of top-level managers (Mondragon, 2009).

At the Mondragon corporate level, through the establishment of a labour framework based on solidarity, both payments and work hours are concerned. In order to avoid differences between co-operatives, pay levels should be between 90% and 110% of the corporate reference.

Mondragon, 2009

Today, proportion has increased approximately to 9:1 (Freundlich, 2009: 46).

### **6. *The first consumer cooperative***

In 1958 the first consumer cooperative is formed under the name of San Jose (Cooperativa de Consumo San José). (Birlirakis, 2005, Mondragon, 2009) They created the specific cooperative, as they understood that using cooperative structures for everyday household supplies could be achieved by increasing the purchasing power of associated workers' (Birlirakis, 2005).

### **7. *Caja Laboral Popular's new institutions***

Its General Assembly represents the interests of cooperatives, while at the same time it equally represents those of its own worker-owners, who are outnumbered two to



one (Whyte and Whyte, 1991). *'Only workers in the Caja, however, elect representatives to its social council'* (Whyte and Whyte, 1991).

Its governing council consists of twelve members of whom the eight represent the cooperatives and tend to be top-management people from the most important cooperatives, and the other four represent workers in the Caja. As Gorrnonitia said *'Caja is thus in the very unorthodox and supposedly unsound position of being controlled by its principal borrowers'* (Whyte, and Whyte, 1991: 68). Caja has a contract of association with the individual cooperatives which governs, as a result, the relations between the contracting parties as the major policies and structures of the associated cooperatives (Whyte and Whyte, 1991).

#### **8. Member-cooperative commitments to Caja**

Each member – cooperative is committed to make an initial contribution to the bank's capital and to conduct all its banking with Caja (Whyte and Whyte, 1991). *'The Caja has the right to perform an audit on member cooperatives once every four years. The audit covers what the Caja calls "social and entrepreneurial aspects" as well as matters that are strictly financial. There is no charge for the audit.'* (Whyte and Whyte, 1991) There is also an agreement that the cooperative establishes its pay scale at 90 and 110 percent of the prevailing rate in the bank, though, this rate drops in periods cooperatives facing financial losses (Whyte and Whyte, 1991).

The technical assistance, credit, and other services the bank offers provide the base for its power and influence. In addition, because of the contract of association, the Caja has strong legal controls over the cooperatives. The contract spells out in detail the norms and processes to be followed regarding not only the internal structures and processes of the member cooperatives but also the obligation to build a strong capital base and to extend employment.

Whyte and Whyte, 1991

#### **9. Caja's four periods of development**

In the first period (1959-1982) it appears as a Savings Banks specializing in attracting savings and in promoting new business activities, something that was fully succeed, since numerous industrial cooperatives and regional groups were developed, through the promotion by the Savings Bank (Caja Laboral, 2011). *'There was also an expansion of Branches from rural areas towards cities, based on a strong personal*

*commitment from the people, an aggressive strategy in prize draws and free gifts, and a differentiated Basque image: Euskadiko Kutxa* (Caja Laboral 2011).

The second period (1983-1990) is characterized mainly by businesses bank does with private customers. It starts business with private customers with mortgages or new liabilities products, and also with companies outside of the Group, starting the offer of commercial discount (Caja Laboral, 2011). Its main contribution to the organisation in this period has to do with its expansion. *'In the search for maximum proximity to each market and to the customers, Regional Bases were set up in each of the provinces, 10 branches per year were opened in the Autonomous Community of the Basque Country and Navarre, and the mass hiring of university graduates began, pre-empting the individuals' qualification needs in order to give added value in the service and treatment offered to the customer'* (Caja Laboral, 2011).

In the third period (1991-1998) the differentiating characteristic is commercial aggressiveness, with differentiated products, such as CAR, Superlibreta, OPV's or Cuenta Joven; and their mortgage prices which were better than those of their competitors (Caja Laboral, 2011).

Finally, the fourth and current period (since 1999) is characterized by gradual disappearance of the advantages in prices/product and the differentiation is now aimed at the quality of the attention, advice and commercial proactivity (Caja Laboral, 2011). *'As regards the organisation, the most characteristic element is an accelerated geographical expansion which spreads from the 4 provinces of the Basque Country towards the bordering territories, and subsequently to Madrid. The commercial activity is divided into two Networks, and two commercial policies, Traditional and Expansion.'* (Caja Laboral, 2011).

#### ***10. Entrepreneurial Devision'sreorganisation and its process to provide new businesses***

In 1981 the division was reorganized into six study and action areas, some of them having two or more departments. At that time, the structure was as follows: (1) research, including the Department of Research and the Library and Documentation Center; (2) agricultural/food promotion; (3) industrial promotion, divided into a producers' area and a promotion and intervention area; (4) consulting, including consultants in exports, marketing, production, personnel, administrative and financial affairs, and legal affairs; (5) auditing and information, including auditing and information control; (6) urban planning, including areas of urban planning, industrial buildings, and housing.

Whyte and Whyte, 1991: 72

In order to provide new businesses, Entrepreneurial Devision followed the process below:

When the project begins with a preformed group of potential entrepreneurs, they approach the Caja, or respond to the Caja's informational and promotional activities. The group proposes that one of its members be the future manager, and he becomes responsible for the feasibility study. If the products area is satisfied with the qualifications of the manager and with the commitment of the founding group, the Caja takes the prospective manager into its produces department and covers his salary for eighteen months to two years, provided the group agrees to consider his salary a loan to members of the group personally or to the firm they hope to concrete. The personal assets of members of the founding group or of their co-signers serve as collateral for such a loan. If the group emerges from an existing cooperative or cooperative group that organisation may agree to back the loan. The produces department then assigns a staff member to serve as sponsor or Godfather (*Padrino*) to work with the prospective manager in carrying out the feasibility study and developing the business plan. The Godfather remains with the firm in an advisory role during startup until shortly after the firm reaches the breakeven point. During this period, he sits on the governing council of the new cooperative.

Whyte and Whyte, 1991

### **11. Lagun-Aro**

Lagun-Aro was a very important institution and empowered Mondragon's independency.

Membership on the council is drawn from the cooperatives, whose payroll deductions cover the social security needs of their members. Lagun-Aro grown rapidly as a result of the expansion of the base cooperatives to which it is linked. By the end of 1984, Lagun-Aro was linked with 140 cooperatives, and it was serving 18,266 members, 47,465 including dependents.

Whyte and Whyte, 1991: 52

Its unique pension system follows:

In the public system, current workers' and firms' contributions pay for the benefits of current retirees, whereas in Lagun-Aro each worker's (and her or his firm's) contributions pay for her or his own retirement. Hence, while Lagun-Aro must also face the rising retirement costs faced by public systems as life expectancy increases, the system is more manageable and predictable. In summary, social security and insurance represents yet another vitally important category of activity that the Mondragon group has addressed through a "second-degree", cooperative network organisation. Worker-members rate Lagun Aro as one of the most highly valued network services offered by the Mondragon group

Freundlich, 2009: 37

## 12. ULARCO

ULARCO, cited in chapter 3, became as a result of the cooperation of the three cooperatives and resulted the creation of two other firms. This process became as follows:

Arrasate had emerged to manufacture machine tools for Ulgor, and Copreci had been created to manufacture components for Ulgor's gas stoves and heaters. The fourth component of the original group, Ederlan, was formed when a privately owned foundry was taken over and combined with the foundry at Ulgor. Fagor Electrotecnica, which produced electronic components and equipment, was created out of elements of the first three cooperatives and formed the fifth firm in the group.

Whyte and Whyte, 1991

The new structure required the creation of three new institutions: the Governing Council, the General Management and Central Social Council.

The Governing Council of ULARCO consisted, at first, of three members of each cooperative and then, when new cooperatives appeared, the representation of each dropped to two and to one (Whyte and Whyte, 1996).

Its members were chosen by the Governing Council of ULARCO and it was responsible for planning and coordination, for reviewing and recommending annual and long-range plans for each constituent cooperative, and for coordinating commercial policies (Whyte and Whyte, 1991).

It was responsible for studying and establishing common systems of administration and administrative structures, for acquiring manufacturing licenses, for maintaining relations with outside organisations, and for overseeing the creation of new firms and new services. It provided personnel, legal, accounting, and some commercial services to the constituent organisations. The centralization of personnel functions facilitates the transfer of members from one cooperative to another within ULARCO. Thus, when one cooperative must curtail its production, some of its workers can be transferred temporarily or permanently to a cooperative that needs additional workers. This has proved to be an important means of stabilizing employment.

Whyte and Whyte, 1991: 60

Another new institution was appeared called *Central Social Council* (earlier called the Permanent Commission). At first, it consisted of two representatives from each cooperative's social councils and then it was made up out of one of each (Whyte and Whyte, 1991). *'The Central Social Council is responsible for studying and evaluating management's plans. This means that management is responsible for keeping it*

*informed and for consulting with its leaders on major plans. The Central Social Council then reports back to the social councils of the constituent cooperatives'* (Whyte and Whyte, 1991).

ULARCO drew together the co-operatives in the Leniz Valley (Mondragon, 2009). The contribution of each cooperative firm to the group differed at first. In the first year, FAGOR Electrotecnica agreed to pool 90 percent and Copreci, Artasate, and Ederlan began by pooling 20 percent of their profits (Whyte and Whyte, 1991). They all committed to increase their contributions by 10 percent in each of the following years (Whyte and Whyte, 1991). *'Ulgor pooled 100 percent of its profits from the outset'* (Whyte and Whyte, 1991).

In 1968, a policy was implemented, by which each cooperative had to pool 100 percent of their profits. The sequence of decisions from 1966 to 1970 reflects the complicated process of adjustment to the new organisational structures and policies and the need throughout the discussions and negotiations to balance the interests of the individual cooperatives with those of the emerging cooperative group.

Whyte and Whyte, 1991: 60

### **13. Alecoop**

In 1966 the cooperative Alecoop (Actividad Laboral Escolar Cooperativa) was established. This cooperative will provide equal opportunities, as it will give the opportunity of students coming from low economic strata to continue their studies as they could work in the cooperatives at the same time. So, these students every day will work for four hours in the cooperatives and four hours will attend classes, while at the same time they have the right to participate in cooperative's management (Birlirakis, 2005).

Alecoop started by producing components on order for other Mondragón cooperatives. While continuing this business, it has attracted increasing numbers of contracts from private firms. Emerging out of the Escuela Politecnica, Alecoop has capitalized on its relationship to the school by developing a line of instruments and equipment for use in science and engineering classes in high schools and universities.

Whyte and Whyte, 1991: 54

In order to involve students-members in governance, the small full-time staff of managers and technical specialists and the other cooperative firms that were contracting some of their work out to Alecoop, a tripartite form of representation was

established, in which the one-third of the members of the governing council is elected by the permanent staff, one-third by the student members, and another one-third by the contracting cooperatives (Whyte and Whyte, 1991). *'In 1984 Alecoop provided employment, earnings for tuition and living expenses, and experience in work and in the cooperative processes of governance to more than 450 student members'* (Whyte and Whyte, 1991).

#### **14. Eroski**

Eroski is a unique organisation as it was hybrid from its very beginning. This is also reflected in its structure.

In the conventional consumer cooperative, membership is limited to consumers, and each member has one vote for the board of directors. Eroski from its beginning has been a hybrid organisation with two categories of membership, one for workers and one for consumers. To balance the interests of the two groups, the governing council consists of equal numbers of elected consumers and workers. According to the Eroski constitution, the chairman of the governing council must always be a consumer.

In the early years of Eroski, the leaders of the cooperative complex saw it as a relatively unimportant sideline, but, later, it grew explosively and gained importance both because of its volume of business and because it has accelerated the growth of the complex.

Whyte and Whyte, 1991: 56

#### **15. Polytechnic Professional School**

At the end of 1960's the Professional School (Escuela Profesional) became a polytechnic and renamed as Escuela Politecnica Profesional (Molina and Miguez, 2008). It had a large number of students and courses in various disciplines such as engineering, electrical, electronic, automation, etc. (Birlirakis, 2005) *'The Escuela Politecnica Profesional provided the base for the creation and development of the cooperatives that would build the Mondragon complex'* (Whyte and Whyte, 1991: 31).

#### **16. Ikerlan**

In the 1970's, a dynamic and continuous development of the Mondragon cooperatives exist, as their number enlarges and they remain profitable (Whyte and Whyte, 1991; Birlirakis, 2005).

In 1974 Ikerlan was created. *'Ikerlan was emerged out of the Escuela Politecnica Profesional under the leadership of Manuel Quevedo, an instructor in charge of shop operations'* (Whyte and Whyte, 1991). It is an advanced technology research center, aiming to conduct industrial and technological knowledge (Whyte and Whyte 1991; Morrison, 1992; Birlirakis, 2005).

### ***17. Policies and measures provided to overcome recession***

The policies Mondragon pursued to overcome the crisis were the followings:

- **Increase capital contributions**: This policy meant that the additional capital contributions of a cooperative member would be secured in equal amounts from the interest paid on each member's capital account in June and December and from payroll deductions for the next three years. Following Spanish custom, the cooperatives had been paying salaries in twelve monthly installments plus two additional payments, which were made in July and December. The plan called for half the required capital contribution to be withheld from the two extra paychecks. For recently hired members, the required total would be secured by withholding additional money from their two extra paychecks. People retiring or facing economic difficulties were excluded.
- **Redistribution of outcome**: this policy provided cooperatives in a group facing losses to be supported by cooperatives that had profits, by capital transfer. This policy allowed cooperatives in groups facing serious difficulties to be strengthened and have better chances to overcome the crisis.
- **Flexibility in working hours**: this new policy adjusted the hours worked per day to seasonal demand. So, hours worked could be increased to ten per day for weeks at a time or reduced to six per day.
- **Repositioning**: cooperatives having surplus in workers amount were obligated to reposition some of their workers to other cooperatives. The reposition could be temporary or permanent in cases cooperatives failed to overcome crisis.
- **Payment Policy**: This policy is directly linked to the economic situation of the cooperative. At this critical period of the 80s in many cases, the cooperative workers had to limit their wages.

Whyte and Whyte, 1991, Birlirakis, 2005

Furthermore, Lagun-Aro established policies providing financial support for relocation, unemployment, early retirement, indemnities and retraining (Whyte and Whyte, 1991).

Relocation: As it was mentioned above a cooperative group could relocate its workers within its cooperatives. However, when the group was unable to do that, Lagun-Aro had the responsibility to find a job to the displaced member in one of the other Mondragon cooperatives and to cover the costs involved (Whyte and Whyte, 1991). When the displacement was temporal, *'Lagun-Aro covered the costs of the worker's travel, per-diem costs, and the difference between the pay the member was now receiving and what he or she received before being displaced'* (Whyte and Whyte, 1991). When the relocation was permanent it paid *'only "extraordinary expenses", the determination of their nature and justification being in the hands of the Governing Council of Lagun-Aro, in consultation with the Relocations Commission'* (Whyte and Whyte, 1991).

Unemployment: in order to support unemployed workers Lagun-Aro paid them 80 percent of their basic salaries and 100 percent of their paying amount for the social security fund (Whyte and Whyte, 1991). *'Unemployed members are allowed to receive up to twelve months of unemployment compensation in any two-year period'* (Whyte and Whyte, 1991). Longer periods of compensation were included for cooperatives that over 25 percent of its workers were out of work - covering them a 24 months of unemployment compensation (Whyte and Whyte, 1991). For members deciding working out of complex or become self-employed the support was discontinued, except for cases in which someone who is self-employed is struggling on far less income than he or she received from the cooperative (Whyte and Whyte, 1991).

Early retirement: in this measure people at the age of 58 and under 65 were obliged if their cooperative had been declared in a state of structural unemployment, as it was difficult for them to be relocated (Whyte and Whyte, 1991). In early retirement – until they reached 65- they got 60 percent of their regular take-home pay and 100 percent of their payments for the social security fund (Whyte and Whyte, 1991). Early retirement was canceled when members were reaching the age of 65 when they received the regular pension and in cases they became self-employed or found another job.

Indemnities: members under 58 years old, contributing at least two years to Lagun-Aro, whose cooperative had been declared in structural unemployment and they were hard to be relocated, had the possibility for a lump-sum or indemnification which



depended on their contribution (Whyte and Whyte, 1991). The lump-sum varied as follows:

A member who has been in the social security system for two to five years receives the equivalent of twelve monthly payments. For each additional year, the lump-sum is increased by one monthly payment. In accepting this indemnification, the member relieves Lagun-Aro of any further financial obligation. If the member gets a job within the cooperative complex in less than a year, he or she is obligated to repay all the support. If the member gets a job after receiving payments for a full year, he or she is required to pay back 75 percent. If the job is secured after two full years, the repayment is 50 percent; after three full years, 25 percent; and after four full years the member has no obligation to repay. A cooperative can agree to supplement what the laid-off member receives from Lagun-Aro.

Whyte and Whyte, 1991: 153

Retraining: the relocation of workers needed their retraining too. Responsible for the retraining were the cooperatives which could receive support from Lagun-Aro after applying to the government for as much assistance as can be granted (Whyte and Whyte, 1991). *'Lagun-Aro helped secure this state support'* (Whyte and Whyte, 1991).

As it was mentioned before, the role of Caja Laboral was highlighted in this period too. Caja's Entrepreneurial Division emphasized on ways to rescue threatened cooperatives (Whyte and Whyte, 1991). For that reason, Caja established three levels of risks for cooperatives: high risk, medium risk and warning of alert level (Whyte and Whyte, 1991). A cooperative, depending on the level of its risk received the proportional intervention from the Caja (Whyte and Whyte, 1991). This contribution was vital for the rescue program of threatened cooperatives as the bank loaned cooperatives with very low even zero interest in some cases and also gave part or even whole of cooperatives' debts (Birlirakis, 2005). As a guarantee for the loans, except for emergency cases, Caja made cooperatives to prepare a five-year business and reorganisational plan with the assistance of an intervener provided by Caja (Whyte and Whyte, 1991).

### ***18. The evaluation system which resulted the 1974 Strike***

The process of evaluation was guided by two sets of criteria, arrived at through study and discussion, one for the job and the other for the job holder. Jobs were to be evaluated based on their requirements for theoretical knowledge, work experience, effort, responsibility for decision making and guiding the work of

others, and (when relevant) physical hardships inherent in the job. The job holder was to be evaluated for overall performance, including output, quality, organizing ability, initiative, sense of responsibility, and cooperation with other workers.

Whyte and Whyte, 1991: 94

### *19. Debates following the 1974 Strike*

As it was mentioned in chapter 3, strike provoked chained reactions and debates, as well as the sharpest attacks yet on the cooperatives and Arizmendiarieta himself. More characteristic were the attacks of ETA and the Church (Whyte and Whyte, 1991: 99). On the one hand, ETA's attack accused cooperatives of *'denying to the working class the role of agent for destruction of capitalism and of the bourgeois state; this means the cooperative project is trapped in its own laws (the laws of the capitalists) against which they should fight'* (Azurmendi 1984, 629, cited in Whyte and Whyte, 1991: 99). On the other hand, Church did not attack the Mondragon cooperatives by name but cooperative movement in general, focusing particularly on the prohibition of the right to strike, described as a fundamental right in all democratic countries and recognized in Spain not only by workers but also by management (Whyte and Whyte, 1991: 99). In comparison, *'the defense written by Javier Mongelos, general manager of ULARCO, and Jesus Larraflaga, manager of Ulgor argued that the cooperatives had highly democratic structures and open channels for the resolution of conflicts and that the strike had been an attack on the basic nature of the cooperative itself'* (Whyte and Whyte, 1991: 99).

Arizmendiarieta chose not to play an active role in the conflict, but used strike as a means of alerting the members to the problems of bureaucracy, writing:

Any system of organisation which attains a certain size runs the risk of being undermined, if within it flourishes a typical bureaucratic and functionary spirit, a fearful illness which degrades any achievement no matter what its nature, as it blocks the dynamic agents which strive to maintain efficiency in response to changing conditions.

Azurmendi 1984, 630, cited in Whyte and Whyte, 1991: 100

Three official meetings were held until their final decision, to readmit strikers. In the first meeting, in 1974, strikers claimed that their decision was their only way showing their dissatisfaction, as the social council was ineffective (Whyte and Whyte, 1991: 100). On the opposite side, *'members of the governing council defended their*

*decision on the grounds that the strike was an open and conscious defiance of the institutional channels established by the cooperatives for handling such problems'* (Whyte and Whyte, 1991: 100). The meeting ended with 62% supporting governing council and 48% the strikers (Whyte and Whyte, 1991: 100). In 1977, the annual meeting of general council discussed a petition to readmit the expelled members, where the social council and governing council did not take side (Whyte and Whyte, 1991: 100). The result was the 61% voting against the readmit, 38% voting in favor and 1% invalid (Whyte and Whyte, 1991: 100). Consequently, the final solution was given in 1978, where the general assembly of ULGOR decided to readmit the worker members, with the support of the governing council (Whyte and Whyte, 1991: 100).

### ***20. New institutions in Mondragon Cooperative Group***

The first major restructuring transform of Mondragon experiment to Mondragon Cooperative Group, created two structural institutions, the Cooperative Congress described above and the Governing council.

The Governing council consists of the heads of various groups of production cooperatives and a representative of each of the support organisations and is elected by the Cooperative Congress (Whyte and Whyte, 1991; Cheney, 1999). There is also a management council. The voting system was formulated as follows:

The general managers of groups with fewer than one thousand workers have one vote, those representing units with one thousand to three thousand members have two votes, and those with more than three thousand members have three votes. FAGOR is the only group that has three votes. One other cooperative group has two votes. Eroski, the Caja, and Lagun-Aro have two votes each.

Whyte and Whyte, 1991: 201

### ***21. Mondragon University's contribution***

As it was mentioned earlier, Mondragon University contributes significant in three separate fields.

First, it has close and permanent relationship with the working world (MU, 2010). Its students have the possibility of combining their studies with part-time work, enabling them to pay for their studies, they carry out work placements at companies and educational centers to complement their education and all students finish their studies with a project in a company (MU, 2010).

*'It should be highlighted that the University of Mondragon is promoting a collaborative research model, which covers from basic research to innovation carried out with the collaboration of three main agents: universities, technology centres and companies'* (Zurbano, 2005). Research development comprise one of the mainstays of its educational system. For this reason, a solid network of support organisations has been created among which IKERLAN and IDEKO, two centers specified in the Technological Research area (MU, 2010). Based on this philosophy, the University of Mondragon promoted its research activities, with the average dedication of teaching staff to R&D and Innovation at 34% (Mondragon, 2009).

The university participates in a lot of R&D and Innovation projects, within the framework of the Corporation's Science and Technology Plan, Basque Government programmes, Provincial Council of Gipuzkoa programmes, programmes at the national level, where the University of Mondragon is the only university directing projects of a "singular and strategic" nature and also in Europe, participating in several projects and leading one of them (Mondragon, 2009). They *'have also promoted the creation of the Garaia Innovation Pole, which brings together the University, Technology Centres and company R&D departments, with the objective of encouraging the joint development of research'* (MU, 2010).

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